JULY • 1961

Massachusetts Law Quarterly

Volume XLVI Number Two

PAGE

Published by . . .

THE MASSACHUSETTS BAR ASSOCIATION

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Business Insurance Agreements

Their Pitfalls and Tax Implications

By HUGH M. MacKAY and JAMES L. MOOREFIELD

Mr. MacKay and Mr. Moorefield are Massachusetts attorneys who specialize in the area of estate planning. The idea for this article arose out of lectures presented by the authors recently under the sponsorship of the Committee on Continuing Legal Education of the Massachusetts Bar Association.

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INTRODUCTION

What tragic irony it is for able men to spend years building a successful business only to lose it or have it put in a state of chaos because one of the principals dies. The death of an active stockholder or partner is the big problem of the close corporation or partnership as it has immediate effects upon the organization, the surviving business associates and the heirs of the deceased.

In a large corporation with stock widely held, the effect of the death of a stockholder may be negligible, but the result is far different in the case of a close corporation or partnership where management and ownership are synonymous. Seldom are the interests of the heirs the same as those of the surviving business associates, for the heirs are usually concerned with income and the surviving business associates are concerned with the continued growth and success of the business. The conflict can bring serious consequences to the business and result in a change in management personnel, a slow-up in business, impairment of credit, loss of employee confidence, and even a forced sale. The organization doing business as

a partnership is faced with the further complication of the automatic dissolution of the partnership upon the death of one of the partners.

Upon the death of one of the business associates, the survivors are faced with the alternatives of (1) continuing the business with the heirs of the deceased who are rarely able to contribute anything useful to the management of the company; (2) selling their interest in the business to an outsider, which can seldom be done without a substantial financial loss; or (3) purchasing the business interest of the decedent. The latter alternative is by far the best solution but it requires a substantial amount of cash at once and agreement with the heirs on a fair valuation of the decedent's business interest may be difficult to obtain.

The heirs of the decedent find themselves presented with the same alternatives of (1) continuing in the business, which they may know little or nothing about, as active or inactive business associates of the survivors, (2) selling their interest to an outsider, or (3) selling their interest to the surviving business associates.

The ideal solution is for the heirs to receive full value for the business interest of the decedent, and for the surviving business associates to receive full ownership of the business—all of this, of course, to be accomplished in an air of friendliness and with the feeling that each party has received fair treatment. Such can be accomplished if the business associates consider in advance (1) the consequences of death or disability, (2) a purchase and sale plan, (3) a sale and purchase price formula which will fairly reflect the present worth of the business and its expected future growth, and (4) a plan for financing the purchase price. To be assured that the desired purposes can be accomplished the resultant decisions should be set forth in a written purchase and sale agreement executed by the interested business associates which will bind the estate and heirs of the decedent.

The written purchase and sale agreement may be any one of several types. In the case of a close corporation, a Stock Redemption Agreement or a Stock or Cross Purchase Agreement may be used. An Entity Purchase Agreement or a Cross Purchase Agreement may be elected to be used for the purchase and sale of a partnership interest. Any of the above types of agreements may be of the trustee or non-trustee type as desired. The purchase money may be supplied from available assets and current earnings or from life insurance policies issued on the life of each party in interest.

The life insurance funded agreement can guarantee that the sale and purchase of the decedent's business interest can be accom-

plished financially. It will assure the future stability and continuity of the business by promoting the good will of the business clients, improving employee morale, and increasing the credit and financial standing of the firm. The insured agreement will give peace of mind to the business associate while still alive for he will have the satisfaction of knowing that his heirs will be provided for at his death, as such agreement provides for a guaranteed market at a fair sales price for his business interest at his death and establishes a value of such business interest for estate tax purposes.

Such insured agreement will provide the surviving business associates with the cash necessary to finance the sale and purchase immediately upon the death of the associate thus assuring them of future control of the business. The insured agreement will benefit the heirs for they can be assured of receiving a fair price in cash immediately for the decedent's business interest, and thus freed from the burdens of business and the responsibilities of management. The immediate receipt of the purchase money will free other estate assets and permit the settlement of the decedent's estate with dispatch.

The solution to the problem outlined seems so simple that there must be obstacles or pitfalls. It is true that there can be obstacles and pitfalls which can result in adverse tax consequence, but such can be avoided by an understanding of the business insurance agreement and its tax implications. As the pitfalls and tax implications differ with each type of purchase and sale agreement, each type must be examined carefully.

STOCK REDEMPTION PLAN

Introduction

For our purposes, when we mention a stock redemption or redemption of stock, we refer to an acquisition or purchase by a corporation of its own stock of any class.

Many of the court decisions, and I think practically all agreements, refer to a purchase of stock by a corporation rather than a redemption except in referring to redemption of preferred stock, but it is a convenient term for use in discussion as it refers only to a purchase by a corporation as distinguished from a purchase by other stockholders or surviving stockholders in their personal capacity. The 1954 Internal Revenue Code defines redemption of stock in Section 317 (b) stating that:

> "For the purpose of this part, stock shall be treated as redeemed by a corporation if the corporation acquires its stock

from a shareholder, in exchange for property, whether or not the stock so acquired is cancelled, retired or held as treasury stock."

And in the definition the word property includes money, securities and other forms of property.

The usual reason for a redemption in a close or small corporation is well stated by the Massachusetts Supreme Court in *Winchell* v. *Plywood Corporation,* 324 Mass. 171, 85 N.E. (2d) 313 (1949) wherein the Court said:

> "The contract at the time it was made was mutually advantageous to Winchell and the corporation. Under it Winchell was assured of a market for his stock and Plywood was protected against the stock getting into the hands of outsiders."

Power of a Massachusetts Corporation to Purchase Its Own Shares

Sometimes these discussions get so tax directed we forget there are or may be questions of substantive law, but here we have the question of power of a Massachusetts corporation to purchase its own stock.

This power is well established by Court decision in Massachusetts.

Winchell v. *Plywood Corporation, supra,* and cases cited therein.

Barrett v. *W. A. Webster Lumber Co.,* 275 Mass. 302, 175 N.E. 765 (1931).

Lewis v. *H. P. Hood & Sons, Inc.,* 331 Mass. 670, 121 N.E. (2d) 850 (1954); common stock callable under articles of organization provision held valid.

In Massachusetts the rule apparently is that if at the time of entering into the agreement there is no prejudice to the creditors or the stockholders, the agreement will be upheld assuming that it is duly authorized by the directors. (See *Winchell* v. *Plywood Corp., supra.)*

The restriction in many other states that such a purchase may only be made out of surplus does not prevail in Massachusetts. *(Barrett* v. *W. A. Webster Lumber Co., supra.)*

Although approval of the stockholders has been held to be unnecessary in absence of provisions in the articles or by-laws to the contrary, most of the decisions have arisen as a result of complaining stockholders and not complaining creditors. Accordingly, if less than all of the stockholders are involved, it will be safe procedure to obtain specific stockholder consent if it can be obtained.

For example in *Braunstein* v. *Devine,* 149 Mass. (2d) 628, 337 N.E. 408 (1958) a single stockholder complained that majority stockholders in effect enriched themselves by having the corporation purchase its own shares. Although this was a substantive law case, this has a rather familiar tax ring. The case was sent back for further hearing.

The doctrine of *Topken, Loring & Schwartz,* 249 N.Y. 206, 163 N.E. 735, raises another question. This doctrine states that if a corporation may purchase its own stock only out of surplus, and since when it enters into a contract to purchase its own shares to be performed in the future it cannot tell if it will have the required surplus, the agreement is illusory and void.

It could be presented in Massachusetts on the grounds that the corporation could not tell if in the future the purchase would prejudice creditors or stockholders.

Although the Court of Appeals in New York has not specifically done so, it has in effect clearly overruled the *Topken* case in later cases without expressly saying so.

Hence in the *Greater New York Carpet House* case, 17 N.Y.S. (2d) 483, it held that if life insurance were used to fund the purchase, the agreement was not illusory.

And in *Murphy* v. *George Murphy Inc.* 166 N.Y.S. (2d) 290 (1957), it in effect eliminates the *Topken* doctrine.

In a recent decision, *Mountain States Steel Foundries, Inc.,* 284 F (2d) 737 (4th Cir., 1960) the 4th Circuit Court in an excellent discussion of this question points out that it really is a wait and see situation and that if surplus exists when it is time for performance, the contract may be performed.

In these stock redemption cases, in Massachusetts as in other states, the remedy of specific performance is available. *(Winchell* v. *Plywood Co., supra).*

Insurable Interest

Since many stock redemption agreements will be funded at least in part by life insurance, the question of insurable interest is present.

A corporation has an insurable interest in the life of its employees or officers.

U.S. v. *Supplee-Biddle Hardware Co.,* 265 U.S. 189 (1924);

Keckley v. *Coschocton Glass Co.,* 86 Ohio St. 213, 99 N.E. 299 (1912);

Vance On Insurance, 3rd Ed., p. 198.

In a corporation in which the stock is closely held, the corporation has an insurable interest in the life of the stockholder for the purposes of stock redemption agreements, since the death of any such stockholder and the sale of the stock to outside interests could result in financial loss to the corporation.

Bohnsack v. *Detroit Trust Co.,* 292 Mich. 167, 290 N.W. 367 (1940);

The Emeloid Co., Inc. v. *Com'r.,* 189 F (2d) 230.

In Massachusetts, in absence of a wagering contract, an assignment to a person having no insurable interest in the life of the insured is valid.

Potvin v. *Prudential Life Ins. Co.,* 225 Mass. 247, 114 N.E. 292 (1916);

Mutual Life Ins. Co. of N.Y. v. *Allen,* 138 Mass. 24 (1884), 52 AR 245;

Taylor, *Massachusetts Life Insurance Law* (1957).

Hence an assignment by any stockholder to his corporation would be valid, and there would be no transfer for value and resulting income tax problem since a transfer to a corporation in which the insured is a shareholder or officer is expected from the transfer for value rule under Section 101 (a) (2) (B), 1954 I.R.C.

In Massachusetts the insurance company is the only person who under substantive law can raise the question of lack of insurable interest in a beneficiary effecting a policy.

Ratte v. *Forand,* 299 Mass. 185, 12 N.E. (2d) 102 (1938).

Payment to the corporation would be a valid payment and the insured's legal representative could not recover the proceeds on a claim of lack of insurable interest.

Compare *Strachan* v. *Prudential Ins. Co. of America,* 321 Mass. 507, 73 N.E. (2d) 840 (1947).

Brogi v. *Brogi,* 211 Mass. 512, 98 N.E. 573 (1912).

Agreements Are Not Testamentary Dispositions

Although the agreements are carried out upon a stockholder's death, they are valid contracts and are not attempted testamentary dispositions.

Murphy v. *Murphy,* 217 Mass. 233, 104 N.E. 466 (1914);

Hale v. *Wilmarth,* 274 Mass. 186, 174 N.E. 232 (1931);

Vol. 10, *The C.L.U. Journal,* pp. 17-22, Winter Issue 1955.

Tax Results from Use of Life Insurance in Stock Redemption Agreements

If life insurance is used by a corporation to provide cash to be used in purchasing the stock of a deceased stockholder, it will be owned by the corporation. It may be payable to the corporation or to a trustee, and it may be payable upon stated conditions to the stockholder's wife or to his family under installment or settlement option provisions of the policy.

The corporation as the owner of the policy will pay the premiums thereon.

The first tax question we may consider is whether or not the premiums paid are deductible by the corporation for income tax purposes.

The corporation would either be a direct or indirect beneficiary under the policy within the language of Section 264 (a) (1) and so the premiums would not be deductible.

Section 264 (a) (1) I.R.C.

Omaha Elevator, 6 B.T.A., 817.

Suppose that a corporation executive brought in by the family owners agreed to work for the corporation partly on the basis of his receiving stock which the corporation would agree to purchase if he died, the agreement at the executive's insistence to be funded with life insurance.

This looks like a business expense but the insurance is still in part for the corporation's benefit. The premiums would not be deductible.

Compare *Klein* v. *Com'r,* 84 F (2d) 310;

Rieck v. *Heiner,* 25 F (2d) 453;

Peerless Pattern Co., 29 B.T.A. 767 in which creditors required the debtor corporation to purchase insurance.

These decisions are correct. The usual policy is to a great degree similar to a savings deposit since it builds a cash value. And in any event the insurance is used to provide the purchaser with cash. It is basically for the benefit of the purchaser.

These cases should be distinguished from those in which a creditor holds an obligation which has been written off as a bad debt and uncollectable, and pays premiums on a policy of insurance on the life of the debtor previously received as security for the indebtedness. (See *First Nat'l Bank of Tulsa* v. *Jones,* 143 F (2d) 652 (10th Cir., 1944) and *Federal Nat'l Bank of Shawnee,* 16 T.C. 54 at page 61 (1951).)

The proceeds will be received free of all income tax if they are paid in a lump sum, and they usually are.

This results from the provisions of Section 101 (a) (1) of the Code which provides that except where there has been a non-protected transfer for value, life insurance proceeds payable by reason of the death of the insured are not taxable.

And Section 101 (a) (2) (B) permits a transfer for value to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer.

Any other transfer for value will result in a part of the proceeds being subject to income tax. The excluded portion would be the amount paid for the policy plus any premiums paid thereon by the transferee.

A transfer for value to a stockholder other than the insured is not an excepted or protected transfer under Section 101 and would result in part of the proceeds being taxable as income.

In actual practice this point comes up more often than it should and it could result in sizeable income tax liability.

If the proceeds are held by the insurance company and paid in installments over a period of years or for life, the payments would be taxable as annuity payments under Section 72 of the Code. The method of taxing annuities is designed to return the cost of the contract in equal tax-free parts over the payment period. Each payment is partially a non-taxable return of capital and partially taxable interest.

Premium Payments not Taxable to Stockholders

Beginning in 1956, the Tax Court found in two cases and a District Court in another that premiums paid by a corporation on life insurance policies issued upon the lives of corporate executive-stockholders were taxable as income to the stockholders.

The cases were the *Casale, Sanders* and *Prunier* cases. The *Prunier* case involved a Massachusetts Corporation. These cases resulted in a real flood of discussion.

Fortunately each decision was reversed in favor of the taxpayer.

As a result of these reversals, the Revenue Service issued Revenue Ruling 59-184 in which the Service adopts and follows the decisions in these cases. The Ruling reads in part:

> "In view of the foregoing court decisions, it is held that whenever a corporation purchases life insurance on the lives of its stockholders, the proceeds of which are to be used in payment for the stock of any stockholder, the premiums on such

insurance do not constitute income to any stockholder, even though the stockholder has the right to designate a beneficiary, if such right of the beneficiary to receive the proceeds is conditional upon the transfer of the corporate stock to the corporation. The payment of premiums by the corporation is merely an independent act by the corporation by which it converts one asset, cash, into another asset, an insurance policy, and such action has no relationship whatsoever to the receipt of income by the stockholders." (C.B. 1959-1, p. 68).

This Ruling makes it clear that payments can be made as designated by the insured, without having the premiums taxable as income, as long as the right of the beneficiary to receive the proceeds is conditional upon the transfer of the corporate stock to the corporation. Having in mind the facts of the *Sanders* case, it does not indicate that the transfer has to be made by the beneficiary.

As of today, there is no possibility of premiums being taxable as income to the stockholders in these stock redemption cases.

Income Tax Situation Upon Death

As indicated, the insurance proceeds will be received free of all income tax under Section 101 unless there has been a non-excepted transfer for value.

The stock of the decedent will take a new basis under Section 1014 (a) equal to the fair market value thereof as of the date of death (or as of the alternate valuation date, one year after the decedent's death under Section 2032 if such date is used). The fair market value will be the agreed purchase price, so there will be neither gain nor loss upon the redemption or sale in these cases.

The purchase price will not constitute a dividend to the surviving stockholders.

Holsey v. *Com'r,* 258 F (2d) 865;
Rev. Rul. 59-286.
Rev. Rul. 58-614.

The result is the same if the agreement provides that a survivor will purchase a portion of the shares of stock, and that the corporation will purchase the balance of the shares.

Zenz v. *Quinlivan,* 213 F (2d) 941 (6th Cir., 1954);
Auto Finance Co., 24 T.C. 416, aff'd 229 F (2d) 318;
Rev. Rul. 54-458 C.B. 1954-2, 167.

These cases must be distinguished from cases in which the corporation owns the insurance and pays the proceeds to a deceased stockholder's estate but in which the stock of the estate goes to a

surviving stockholder and not to the corporation. In this category are the *Zipp* case, 259 F (2d) 119 (6th Cir., 1958); the *Duran* case, 246 F (2d) 934 (9th Cir., 1957); *Frank P. Holloway,* 203 F (2d) 566 (6th Cir., 1953) and *Wall* v. *U. S.,* 164 F (2d) 464 (4th Cir., 1947).

Estate Tax Considerations

If the agreement is properly prepared so that transfer of the stock is restricted or forbidden during the stockholder's lifetime, the agreed purchase price is binding for Federal estate tax purposes.

Regs. Sec. 20.2031-2 (b);
Estate of Salt, 17 T.C. 92 (1951) acq.;
May v. *McGowan,* 194 F (2d) 396 (2nd Cir., 1952);
Fiorito v. *Com'r,* 33 T.C. No. 51 (1959).

If transfer is not restricted, the agreed purchase price is not binding.

Regs. Sec. 20.2031-2 (b); 20.2031-3;
Claire G. Hoffman, 2 T.C. 1160 (1943);
Estate of Trammel, 18 T.C. 662 (1952);
Armstrong's Estate v. *Com'r,* 146 F (2d) 457 (1944).

The reason for this distinction appears in the Regulations wherein it is pointed out that in absence of said restrictions the stockholder may sell his stock at any price and hence up to the date of his death he could sell the stock for its fair market value.

The considerations here apply equally to cross purchase agreements.

Perhaps too often stockholders become too concerned about pegging the price of their stock for estate tax purposes, and not enough concerned about getting the fairest price possible for their families. In many of these cases the stockholder's estate will range between the 30% and the 45% estate tax bracket and emphasis may be better placed on obtaining a fair price for the stock.

Unreasonable Accumulation of Surplus, Sections 531-537

The question arises as to whether or not accumulating funds to be used to redeem stock is an unreasonable accumulation of surplus within Sections 531-537 of the Code.

First we should recognize that Section 535 (c) (2) permits a corporation (other than a holding or investment company) to accumulate up to $100,000 without any problem.

In the *Journal of Taxation* for January, 1961, there is a dis-

cussion of the *Pelton Steel Casting Co.* case, 28 T.C. 153 (1957), 251 F (2d) 278.

In this case, the corporation used $300,000 of its own funds and borrowed $500,000 to purchase 80% of its stock from two stockholders. It paid no dividend in this year although it had done so rather consistently before.

The Court found that if the corporation had first declared a dividend of the 1946 earnings, the principal seller would have had to pay $102,169 more income tax than he did. On this basis the Court found no business purpose and an intent to use the corporation to avoid payment of income tax by its stockholder.

The Court was not convinced by the desire of the remaining stockholders to keep the corporation as a going concern and as a separate entity, the sellers having tried to sell their stock to other interests.

A private ruling holds that *Pelton Steel* does not mean that all redemptions are not as such for a corporate purpose.

In the *Mountain States Steel Foundries, Inc.*, v. *Com'r, supra,* one of two 50% stockholders died. His widow and daughters wanted to sell the business, and as a result the surviving stockholder attempted unsuccessfully to do so. Upon the suggestion of the accountant, it was agreed that the corporation would purchase the stock of the widow and her daughters for $50,000 in cash, with the balance payable in notes.

The Tax Court held that there was no business purpose and that the sellers must have learned of the tax consequences from their accountant and acted to avoid a surtax on additional income to stockholders.

The 4th Circuit found that there was a corporate purpose, that there was no indication that the cash accumulated was unreasonable in amount. The Court also said that *the fact of redemption in itself provides no basis for imposing the penalty tax,* and that there was no indication that the purchase payments were withdrawn from excess funds accumulated from earnings beyond reasonable corporate needs.

In statements which were not necessary for the actual decision, and which are reminiscent of some of the statements in the *Emeloid* case, the Court pointed out that the payment of premiums on life insurance serves a corporate purpose (citing *Emeloid, Prunier* and *Sanders)* and said that "if disbursements to create a fund with which to purchase stock serve a corporate purpose, surely the disbursement of the created fund in purchasing the stock serves the same purpose."

The Court also indicated that at least in the 4th Circuit, the

carrying out of a purchase under Section 303 would not result in the penalty tax, since when Congress encouraged such transactions it hardly could have intended to penalize the corporation for doing the favored act.

The case is important in that it recognizes a business purpose in stock redemption and it is comforting because of its pleasant dicta.

There are some attorneys and others who feel that in these redemption agreements the life insurance should never be mentioned but should be carried as key man insurance since it is perhaps easier to find a business purpose for key man insurance (See Brown, "Stock Purchase Agreements" 1956 Southern California Tax Institute p. 537).

Although a business purpose will be present in most of these cases, it has been pointed out that even if a penalty is assessed, the rate (27½% or 38½%) may be considerably less than the tax that would be paid by the stockholder in his individual capacity if the dividend had been declared.

Ownership Attribution, Sections 302, 318

Perhaps the most troublesome questions in stock redemption cases arise in situations in which stock owned by other persons are attributed to the seller, most often the estate.

Prior to 1954, although a person who sold less than all of his stock could be found to have received dividend income, if he sold all of his stock, he was subject to capital treatment. The fact that his son or daughter or someone else also owned stock did not result in dividend treatment. Attempts by the Service to tax the purchase price as dividends were not successful.

Section 302 (a) starts out very nicely by saying that a redemption of stock is a payment made in exchange for the stock.

But then (b) says this is true only if the redemption is not essentially equivalent to a dividend.

Next comes the substantially disproportionate redemption provision. This provision is not met very often in redemptions that take place upon the death of a stockholder, although it could be. It provides in substance that after a redemption, the seller must end up with less than 50% of the combined voting power, and the ratio of his voting stock to all voting stock must have been decreased by more than 20%. This test relates to reduction of the equity interest of the stockholder.

If the selling stockholder can meet these tests, he will not receive dividend treatment.

Section 302 (b) (3) provides that an exchange takes place if

the redemption is a redemption of all of the stockholder's stock. This is the provision that will usually apply in the more or less standard close corporation case.

Section 302 (b) (5) provides that if the case qualifies as a redemption that is not essentially equivalent to a dividend, it does not matter that it is not a substantially disproportionate redemption or a total redemption of all of the stock. This "not essentially equivalent to a dividend" provision is often referred to as the "basket" provision, but most attorneys are reluctant to rely upon it.

In determining whether any of the tests have been met, the constructive ownership of stock provisions of Section 318 must be considered.

There are six basic constructive ownership situations.

The first covers members of the family. An individual is considered as owning stock owned directly or indirectly by or for his spouse (unless separated by decree of divorce or separate maintenance), and children, grandchildren and parents. You go down two steps so as to include grandchildren, but up only one step to parents. Legally adopted children are included. Sons-in-law or any other in-laws are not included and neither are brothers or sisters as such.

Stock owned by an estate is considered as owned proportionately by the beneficiaries of the estate. Stock owned by beneficiaries of an estate is considered as owned by the estate. This is the provision that can cause the most difficulty in close corporation cases in which the stock is family owned.

Similar rules apply to partnerships and trusts.

If a person owns 50% or more of the stock of a corporation he is considered as owning such stock on a pro rata basis, and the corporation is considered as owning all of the stock owned by the corporation.

Finally, if a person owns an option to acquire stock, he is considered as the owner of the stock itself.

In the close corporation case, as stated, the problem usually will arise in a family ownership case.

For example, a father owns 500 shares of stock of Atlas Corporation. His son who is production manager owns 50 shares which were given to him by his father. The father dies and all of his 500 shares are redeemed by the corporation. All of the estate goes under the father's will to his widow who owns none of the stock. It is possible that by first attributing the son's 50 shares to the mother, and then by attributing the same 50 shares to the estate, since the mother is the beneficiary under the will, the estate could not meet either

the entire redemption test or the substantially disproportionate test, and hence the purchase price paid for the 500 shares may be considered a dividend. It is interesting that the Regulations contain no such examples, but Revenue Ruling 59-233 which involved a trust suggests that this double attribution would be applied. In that case a trust for children owned shares and the father of the children owned shares. All of the shares of the trust were to be redeemed. The ruling holds that the father's shares will be attributed first to the children and then to the trust so that the trust would have dividend income if the shares were redeemed.

The Ruling also holds that the family rules which appear in Section 302 (c) (2) and which would have given relief in the situation described in the Ruling are not available to trusts and estates.

The Ruling is severely criticized in the January, 1961 issue of *The Journal of Taxation* and in the May, 1960 issue of the same magazine writers take the position that it is contrary to legislative intention, but Section 318 (a) (4) does say that with one exception stock constructively owned because of the provisions of 318 should be treated as actually owned in applying the provisions of 318. In our example, this appears to mean that the mother is considered as actually owning the stock of the son.

There is at least one reason why dividend treatment should not result in this case. The real reason for the redemption is to get the family out of the business on a fair purchase price basis and let the son have the full ownership and control of the corporation. The transaction has a real business purpose and is not essentially equivalent to a dividend. Section 302 (b) (5), the basket provision should apply. Compare *Estate of Squier,* 35 T.C. No. 105 (1961), and *Herbert C. Parker,* T.C. Memo. (1961-176).

A similar case is the *Thomas G. Lewis* case, 35 T.C., No. 11, October 20, 1960. The facts are these. Mrs. Beyer owned 156 shares out of a total of 283 shares of a family corporation. The remaining 127 shares were owned by Mrs. Beyer's daughters and their husbands. The corporation had loaned her some $20,435 over a period of years. The estate did not have cash to pay the loan so it arranged with the corporation to have it redeem 51 shares in payment of the loan. This was done and the remaining 105 shares were distributed by the estate to the daughters of the decedent.

It was held that the amount of the debt discharged by the redemptions of the 51 shares of stock constituted a dividend to the estate. The Court first attributed the shares of stock owned by the husbands of the daughters to the daughters, and then attributed all of the stock owned by the daughters (actively and construc-

tively) to the estate, since the daughters were beneficiaries under the will when the redemption took place. Hence the estate as a result of this attribution of ownership owned all of the stock of the corporation. It continued to own all when the redemption took place and so under Sections 302 (b) and 318 (a) (2) the transaction was substantially equivalent to a dividend.

There was a way out for Mrs. Beyer's estate. The gifts of stock to her daughters were specific legacies. That is she gave the stock definitely or specifically to her daughters. If the stock had been given to the daughters first, and if all of their gifts under the will had been paid to them so that they would no longer be estate beneficiaries, then under Regulations Section 1.318-3 (a) they would no longer be considered as beneficiaries of the estate. The 51 shares that were redeemed would have been all of the stock of the estate, and this would have been a termination of the estate's stock interest, and not a dividend under Section 302 (b) (3).

It seems rather unbelievable that the order of carrying out the transaction should result in such a different tax treatment, but it can.

Under the Regulations Section 1.318-3 (a) in the *Atlas Corporation* case suggested above, the mother's gift would have been satisfied from other assets and if she had received her gift before the redemption, she would not be a beneficiary of the estate. Very often, however, this is not possible.

These family owned corporation cases and redemption agreements, many of which exist, may have dangers. In any event any existing or new agreements should be reviewed or drafted with these constructive ownership rules in mind.

In some of these cases Section 303 agreements or cross purchase agreements may be the solution. Another possible solution is to let the wife or other members of the family own a sizeable amount of life insurance—equal in value to a pro rata share of the stock they would have received had it been distributed equally among the family, and then leave the stock to the son or sons who are to continue the business. This plus a provision that the corporation will continue a reasonable portion of salary for a reasonable period may be a desirable alternate plan in some family situations.

Section 303 Agreements

We come now to Section 303 agreements. Section 303 is a liberalization of former Section 115 (g) (3). You may recall that hearings were held in Washington and many owners of small corporations made it clear that all of the stock would have to be sold to pay taxes and costs and requested some relief, which 303 gives.

However, certain requirements must be met. The stock must comprise more than 35% of the gross estate or 50% of the taxable estate of the decedent stockholder. Because of the wide use of the full marital deduction, it is usually easier to meet the 50% test whenever the marital deduction is used and is available.

The distribution and redemption under 303 qualifies in an amount equal to the extent of all death taxes plus any interest thereon and in addition funeral and administration costs allowable under Section 2053.

It is not, however, necessary to use the redemption price or any part of it in the payment of any such taxes or costs. It would be possible in an estate that had no estate tax to use 303 to get enough cash out of the corporation free of dividend taxes and usually free of any income tax in order to pay funeral and administration costs if the 35% or 50% test can be met, but usually 303 will have application in larger estates.

The distribution in the redemption must take place within 3 years and 90 days after filing the estate tax return or within 60 days after the decision of the Tax Court if a petition is filed in the Tax Court. This is certainly ample time in most cases.

If more than one corporation is involved, 303 can be used but only if the gross estate includes more than 75% in value of the stock of each of the corporations, and this can be a difficult test to meet.

The redemption can be made by the executor, administrator and heir, legatee, spouse, joint tenant, trustee of a trust created by the decedent, who take from the decedent where the stock is in the gross estate, including stock received in a gift made in contemplation of death. There is no requirement that any of the stock redeemed bear any portion of the estate tax.

The redemption cannot be made from one who acquired the stock by gift or purchase from a person who acquired the stock from the decedent (Regs. Sec. 1.303-2), or who acquired the stock from the executor in satisfaction of a specific monetary bequest. This could create a problem for a widow or a trustee of a marital deduction trust under a usual formula clause since Revenue Ruling 56-270 holds that when the marital gift is satisfied under the formula this results in a specific monetary bequest. There is a proposed amendment intended to avoid this problem.

In 303 cases the problem of valuation can be troublesome. If the price is set too high this is an invitation to the Internal Revenue Service to value the rest of the stock at the same high valuation.

If the price is set too low, the purchase price may not equal the final taxes and costs.

It is possible to provide an initial price which may be used in more than one sale when taxes and costs are finally determined or when the final determination is not in very much doubt. Since there is no requirement that the redemption take place all on one date, this is a workable solution.

Another method is to create a class of preferred stock with the usual stated dollar face amount. Since 303 takes precedence over 306, there is no 306 problem and in any event 306 stock loses its taint following the death of the stockholder.

In these cases it seems clear that the price agreed upon for 303 redemption will not peg the price of any of the shares not sold under 303. It would be a factor to be considered but it would not be conclusively binding.

It is sometimes difficult to meet the 35% or 50% requirement. If there is only one corporation this can sometimes be accomplished by making lifetime gifts—that do not end up as gifts in contemplation of death.

The problem usually arises when there is more than one corporation and the 75% test cannot be met. For example, in a case involving 28 separate restaurant corporations spread throughout many states with two brothers and their wives each owning a 25% interest in each corporation both the 35% and 50% tests could be met but the 75% test could not be met.

The following is suggested as a method of overcoming this difficulty. All of the stock of a shareholder is placed in a holding company which is liquidated after death under Section 333. The various stocks are combined in one corporation, the holding company, and so the 35% or 50% test is met and the 75% test eliminated.

On death the estate owns the qualifying stock which is the personal holding company stock.

The holding company is then liquidated after death under Section 333 and under Section 334 (c) the original stock of the several corporations takes over the basis of the holding company stock which qualifies for Section 303 treatment under Section 303 (c).

By this device the non-qualified stock becomes qualified for 303 treatment, thereby indicating the ridiculousness of the 75% in value test.

Merger and consolidation would be other plans to use but these plans might for many reasons not be desirable. Merger and consolidation would have been disastrous in the 28 service corporations case that is mentioned above.

Where more than one family owns stock, there is always a question of loss of voting control or at least 50% ownership if 303 is

used. This can be avoided by recapitalization into voting and non-voting stock. Perhaps the use of voting and non-voting common may be preferable to voting common and preferred because of certain cost basis problems that may exist.

There could be a problem of improper accumulation of surplus. There is a very pleasant dictum concerning this question in *Mountain States Steel Case, supra.* Here the Court said:

> "For a long time there was controversy over the tax consequence to shareholders when a corporation made disproportionate distributions in partial redemption of its stock. Congress finally acted in this field. Among other things, it specifically provided that a partial redemption of the share held by an estate would be treated as a sale, not as a distribution of earnings, if the amount of the distribution did not exceed the estate's liabilities for estate and inheritance taxes, interest and funeral and administration expenses. When Congress specifically provided favorable tax treatment for such transactions and sought to encourage them to facilitate the administration of estates, it hardly could have intended to penalize the corporation for doing the favored act."

If key man insurance is used to fund the agreement, there would not usually be any accumulation of surplus problem, because it is not the redemption but the unreasonable accumulation that causes the problem. There are enough problems and we should not try to make problems when no problems exist—an approach which many law review writers fail to recognize possibly to the later chagrin of taxpayers.

For an excellent and complete discussion with respect to Section 303, see Richard Barrett "How to Handle Distributions In Redemption of Stock to Pay Death Taxes—Section 303" Prentice-Hall *Tax Ideas* (1958).

STOCK PURCHASE PLAN

A Stock Purchase plan, or cross purchase plan as it is often called, is an arrangement between two or more stockholders whereby it is agreed that upon the death of one of them his shares of stock will be sold to and be purchased by the survivor or survivors.

When the Stock Purchase plan is funded by insurance, each stockholder is the applicant, owner and beneficiary of a life insurance policy issued on the life of each of the other stockholders who are parties to the Agreement. For example, if A, B and C are the sole stockholders of a corporation and each of them is a party to a Stock

Purchase Agreement, A would in the usual case be the applicant, owner and beneficiary of a policy issued on the life of B and of a policy issued on the life of C; B would similarly insure the lives of A and C, and C would insure the lives of A and B. Under such an arrangement, six insurance policies are necessary.

In order to keep the number of policies to a minimum and in order to save money by taking advantage of an insurer's "graded premium by size of policy" premium rates, it is sometimes requested that the stockholders, other than the Insured, be co-applicants, co-owners, and co-beneficiaries of the insurance policies. While only three policies are required under such an arrangement and a few premium dollars might be saved, the disadvantages and the problems of the control of the policies in the event that one of the co-owners of an insurance policy dies, sells his stock or otherwise ceases to be a party to the agreement are readily apparent.

In some cases it may be desirable to have a qualified, disinterested trustee carry out the Stock Purchase Agreement of the parties. If such is the case, the trustee should be designated in the Agreement and in each of the insurance policies as the policy beneficiary, and the stock certificates endorsed in blank and deposited with the trustee. If it is desirable to also have the trustee control the insurance policies, the attorney drafting the Stock Purchase Agreement should take special caution to avoid any provision in the Agreement which would require the consent of all parties to the Agreement before the trustee is permitted to exercise policy rights as such a provision would give the insured an incident of ownership in the policy which could cause the full amount of the policy proceeds to be included in the insured's gross estate under Section 2042 of the Internal Revenue Code. Even though the trustee has sole policy ownership rights, consideration should be given to the question of whether premium payments by the corporation would constitute taxable income to the trustee.

In any event, the Stock Purchase Agreement should clearly show who is to hold legal ownership of the policies, the manner in which such ownership rights may be exercised, and who is to be the beneficiary of the insurance proceeds.

Stock Purchase plans would generally be used in preference to a Stock Redemption plan in the following instances:

1. When state law or corporate charter prohibits or restricts a corporation from purchasing its own stock. Stockholders always have the right to purchase and sell stock among themselves.

2. When less than all of the stockholders are involved in the purchase and sale plan. All stockholders are directly or indirectly participants to a Stock Redemption plan but one or more stockholders may be participants in a Stock Purchase plan.
3. When the purchase money is likely to be construed to be equivalent to a distribution of a dividend under the rules of attribution. Sections 302 and 318 of the Internal Revenue Code. The rules of attribution of Code Section 318 are applicable only to Stock Redemption plans. A stockholder can participate in a Stock Purchase plan with his spouse, children, grandchildren and parents without any fear that the purchase price will be construed as a corporate dividend.

   Commissioner v. *Decker*, 32 T.C. 326 (1959), aff'd, 286 F. 2d 427 (Dec. 12, 1960), is an interesting case which involved a Stock Purchase plan and Code Section 302. At the time of the death of one stockholder in 1953 and of another in 1954, the survivors were financially unable to purchase the stock of the decedent. In order to carry out their obligations under the Stock Purchase Agreement, the survivors borrowed money from the corporation and then immediately resold the decedent's stock to the corporation at their purchase price to satisfy their loan obligation. The corporation held the stock as Treasury stock. The Commissioner claimed that as corporate funds were used to satisfy personal obligations the purchase money was equivalent to a dividend distribution, but the Court held that the stockholders had received no economic benefit, that tax avoidance was not a major consideration, that the purpose of the Agreement was to keep the stock out of the hands of the widows, minors and unfriendly outsiders, and therefore the stock redemption from the survivors was not essentially equivalent to a dividend distribution.
4. When the business purpose is likely to be questioned. The problem does not arise under the Stock Purchase plan.
5. When accumulations of surplus are apt to be construed to be beyond the reasonable needs of the business and thus subject to Code Section 531 penalty taxes. While the chances of Section 531 penalty taxes being imposed because of life insurance policy cash values have been greatly minimized under recent court decisions, the Stock Purchase plan does not present the problem at all.

Emeloid Company, Inc. v. *Commissioner,* 189 F. 2d 230 (3rd Cir., 1951).

Pelton Steel Casting Co. v. *Commissioner,* 251 F. 2d 278 (7th Cir., 1958).

Mountain State Steel Foundries, Inc. v. *Commissioner,* 60-2 USTC Par. 9797, (4th Cir., Nov. 7, 1960).

6. When the financial position of the corporation is such that the cash values or death proceeds of the insurance policies as assets of the corporation are apt to be demanded to satisfy creditors. Under a Stock Purchase plan the insurance policies are owned by the stockholders, not by the corporation, and are classified as the personal property of the policy owner not subject to the claims of creditors of the corporation, although such policies may be subject to the personal creditors of the policy owner.
7. When a disproportionate distribution of the decedent's stock among the surviving stockholders is desired. While a Stock Purchase plan can and usually does effect the same proportionate distribution as a Stock Redemption plan, only a Stock Purchase plan can effect a disproportionate distribution.
8. When a surviving stockholder desires a stepped-up basis for the stock he purchases. The redemption and retirement of the decedent's stock under a Stock Redemption plan will enhance the value of the shares of the survivors, but the cost basis for determining gain or loss for income taxes on subsequent sales does not change. The cost basis of the shares purchased by the survivors under a Stock Purchase plan will be the price paid in accordance with the agreement, but the cost basis of the original shares held by the survivors are unaffected by the Stock Purchase plan. The question of the cost basis of the stock under either a Stock Redemption or Stock Purchase plan is important only if the survivors stock is subsequently sold.

The advantages of the Stock Purchase plan over the Stock Redemption plan have been listed in the preceding paragraphs, but what of its pitfalls, the complicating factors? Stock Purchase plans are complicated in the following cases:

1. When large numbers of stockholders are involved. As it is generally preferable for each stockholder to own an insurance policy on the life of each of the other stockholders who is a party to the Stock Purchase plan, the number of insur-

ance policies involved can become unwieldy. For example, three stockholders to a Stock Purchase plan require six policies, whereas only three policies would be required under a Stock Redemption plan; ten stockholders involved in a Stock Purchase plan would require each stockholder to own nine policies thus making a total of ninety policies for the group—ninety policies as compared to ten policies under a Stock Redemption plan! If more than four or five stockholders are involved, a Stock Redemption plan is generally preferable.

2. When extreme difference in the ages of the stockholders make it desirable to pool policy premiums.
3. When individual income tax brackets are such that it becomes extremely costly to increase dividends or salaries sufficiently to pay premiums or when such increased salaries are apt to be construed to be excessive.
4. When the "transfer for value" rule is likely to be applicable. As a general rule, life insurance paid by reason of death are wholly exempt from income taxes under Section 101 (a) (1) of the Internal Revenue Code. The exception to this general rule is the "transfer for value" rule.

> "In the case of a transfer for valuable consideration, by assignment or otherwise, of a life insurance contract or any interest therein, the amount excluded from gross income by paragraph (1) shall not exceed an amount equal to the sum of the actual value of such consideration and the premiums and other amounts paid by the transferee." Code Section 101 (a) (2).

Subparagraphs (A) and (B) of Sec. 101 (a) (2) set forth the exceptions to the "transfer for value" rule and the latter subparagraph is especially important to purchase and sale agreements. Subparagraph (B) provides that the "transfer for value" rule shall not apply in the case of such a transfer "if such transfer is to the insured, to a partner of the insured, to a partnership in which the insured is a partner, or to a corporation in which the insured is a shareholder or officer." But note, the exception to the "transfer for value" rule does not extend to transfers for value between stockholders.

At the death of a stockholder, the policies owned by the decedent under a Stock Purchase plan pass to his estate. If the policies are then transferred for value by the estate to the insured, the death proceeds would not be affected by the "transfer for value" rule, and this could be important if the insured is then uninsurable and needs

the insurance for his insurance estate, but the proceeds would not be available for further financing of the purchase and sale agreement still existing between the surviving stockholders. If the policies are transferred for value by the decedent's estate to the surviving stockholders, other than the insured, so as to be available for the continuing obligations under the Stock Purchase Agreement, the amount of the proceeds available would be limited as that part of the proceeds in excess of the transfer consideration plus subsequent premiums paid would be subject to income taxes under the "transfer for value" rule since transfers between stockholders are not recognized exceptions to the rule. When the corporation owns the insurance policies under a Stock Redemption plan and has the obligation to redeem the stock of the decedent, no transfer of the policies on the lives of the survivors is necessary and the full amount of the insurance on the lives of the survivors will be available for purposes of funding the continuing obligations under the Stock Redemption Agreement without running afoul of the "transfer for value" rule.

The "transfer for value" rule and its exceptions can also be important when initially considering the type of purchase and sale plan to be used. Often times one or more of the stockholders is uninsurable but has existing insurance in force which could be used to fund the purchase and sale agreement. If the Stock Purchase plan were used an assignment of the existing policies to the other stockholders would be required. Such an assignment, not being a recognized exception to the "transfer for value" rule, would result in a part of the proceeds being taxable to the policy assignee at the insured's death and thus limit the amount available to carry out the Stock Purchase Agreement. If the plan were a Stock Redemption plan, the uninsurable's existing policy could be transferred to the corporation and be within a recognized exception to the "transfer for value" rule.

As the advantages and disadvantages of the Stock Purchase plan have been compared with the Stock Redemption plan, the tax implications of the Stock Purchase plan should be reviewed.

In the *Sanders, Prunier* and *Casale* series of cases, previously cited, the question of the corporation's payment of insurance premium constituting a dividend was involved. The appellate courts and Revenue Ruling 59-184, C.B. 1959-1, 65, resolved the question by in effect holding that such payment of a premium on policies owned by the corporation did not constitute a dividend to the stockholders. Revenue Ruling 59-184 also stated that in the case described as a Stock Purchase plan, where the corporation is not a party to the agreement, premiums paid by the corporation would be considered

as distributions of dividends to the various stockholders who are the owners and beneficiaries of the policies. The ruling referred to the case of *Doran* v. *Commissioner,* 246 F. 2d 934.

If the stockholder-policyowner pays the premium, the question of the premium constituting a dividend is avoided. When establishing a Stock Purchase plan, however, it is generally found that the policyowner feels that he cannot afford to pay the premium with out-of-pocket money or to have it withheld from his current earnings. In such cases, it is generally agreed that the corporation will increase the stockholder-employee's salary by an amount sufficient to pay the premium on the policies he owns on the lives of the other stockholders. If the corporation treats this increase as additional compensation to the stockholder-employee, and if the employee's total compensation can be justified as a reasonable compensation for the services rendered, then the question of the premium constituting a dividend should be avoided despite the statement in Revenue Ruling 59-184 to the contrary. Actually, the *Doran* case, cited in Revenue Ruling 59-184, held that the premium paid by the corporation did not constitute a dividend. The case did, however, cite the example of a corporation receiving the insurance proceeds and distributing such proceeds to the stockholders and said such distribution would constitute a dividend; but this example can be distinguished from the case where the premium is paid by the corporation as additional compensation to the policyowner who in turn pays the tax on such premiums.

It is clear from Code Section 264 (a) (1) and Regulation Section 1.264-1 that premiums paid by the policyowner on the life of the insured are not deductible business expenses.

As has already been discussed, insurance proceeds paid on account of death are wholly exempt from income taxes under Code Section 101 (a) (1), unless the "transfer for value" rule is applicable; therefore, the stockholder-owner-beneficiary would receive the insurance proceeds income tax free in the usual Stock Purchase plan.

As the deceased stockholder's stock takes a new or stepped-up basis equal to its fair market value at date of death, there will be no taxable gain realized by the decedent's estate at the time the stock is sold to the survivors if the purchase price paid by the survivors equals the fair market value at time of death. Code Section 1014 (a). As will be discussed in detail subsequently, one of the prime purposes of the purchase and sale agreement is to establish a value of the decedent's stock at time of death.

As has already been discussed, the question of the rules of attri-

bution under Code Section 318 and the question of the purchase price constituting a dividend under Code Section 302 are avoided under the Stock Purchase plan as the corporation is not a party to such a plan.

In many cases involving an insured Stock Purchase plan, the insured dies soon after the insurance policies are issued and only a few premiums have been paid. The question then arises as to what is the proper cost basis of the stock to the surviving stockholders who purchase the stock of the decedent? Is the cost basis to the purchaser the amount of premium which he paid for the insurance policy making it possible for him to acquire the decedent's stock, or is it the actual purchase price paid? As the premiums paid do not constitute a business expense deduction and as the death proceeds of the policy are income tax free under Code Section 101 (a) (1), there seem to be no question that the new basis to the purchaser is the full purchase price paid. Cf. *Barkley A. Storey* v. *U. S.*, D. C. Ky., 61-1 USTC Par. 9439.

When one stockholder to a Stock Purchase plan dies, his estate seldom has need for the policies which he owned on the lives of the survivors. In most agreements, provision is made for the insured or one or more of the survivors to purchase these policies from the decedent's estate, but as has already been discussed, such purchase can cause the death proceeds of the policies to be subject to income taxes under the "transfer for value" rule unless the purchase falls within one of the exceptions to this rule. Code Section 101 (a) (2) (B).

Although the type of agreement to be used in a given situation and its income tax consequences are important, the drafter must not overlook the value of the agreement for Federal estate tax purposes and its estate tax consequences. Will the proceeds of a life insurance policy purchased by a business associate on the life of the decedent under a Stock Purchase plan be includible in the decedent's gross estate when the decedent at the same time and for the same purpose purchased a similar policy of insurance on the life of the business associate? The question here is whether under the circumstances the decedent may be considered as having paid the premium on and retained the incidents of ownership in the policy on his life under the reciprocal trust doctrine? This was the very question which was answered in Revenue Ruling 56-397, C.B. 1956-2, 599, and it was held that the proceeds of the policy on the decedent's life were not includible in his gross estate but that the value of the unmatured policy owned by the decedent on the survivor's life was includible in

the decedent's estate under Code Section 2033. The proper value of the policy owned by the decedent on the life of the survivor, which is to be included in the decedent's estate, is the interpolated terminal reserve value as of the date of death, plus any premium paid prior to death which is applicable to a subsequent period. See Regulation 20.2031-8 (b) and (c); cf. Revenue Ruling 59-195, C.B. 1959-1, 18. Although the policy's cash value at the time of the policyowner's death may approximate the interpolated terminal reserves of the policy the amounts will not be exact; therefore the attorney or executor needing such information for estate tax return purposes should obtain the exact figure from the insurance company.

One of the principal objectives to be accomplished by a purchase and sale agreement is to fix the value of the decedent's stock for estate tax purposes. The purchase price determined by the Agreement will be accepted as the fixed value of the stock for estate tax purposes if there is an obligation to buy and sell the stock, and if the Agreement prohibits the owner of the stock from disposing of his stock during his lifetime without first offering the stock to the other party or parties to the Agreement at a price not higher than the contract price, assuming of course that the Agreement is the result of an arm's length transaction. Reg. 20.2031-2 (b); 20.2031-3; Revenue Ruling 157, C.B. 1953-2, 255.

In *Estate of Robert C. Gannon*, 21 T.C. 1073 (1954), a mere restriction not to sell during lifetime without the consent of the other parties was held not to be effective for estate tax valuation, but in a later case, *Estate of Lionel Weil,* 22 T.C. 1267 (1954), acq., such restriction was held to have the effect of limiting the lifetime price to the value set out in the agreement.

The advantages of fixing the estate value of the stock are easily apparent. The fixed value eliminates controversy with the Internal Revenue Service and makes possible more exact computations of future estate tax liability. See 15th Annual of New York University's *Institute On Federal Taxation* (1957), "Buy and Sell Agreements: A Review and a New Look," by Morris R. Friedman.

Neither time nor space permits a discussion on the methods for evaluating the stock of a close corporation or the factors to consider when selecting the appropriate valuation formula for the written Agreement. Although the problem of valuation is really one for the company's accountant, Revenue Ruling 59-60, C.B. 1959-1, 237, can be most helpful to the attorney when considering Regulation 20.2031-2 and its inadequacy in covering the valuation problems of the close corporation.

PARTNERSHIP LIQUIDATION AGREEMENTS

Introduction

Prior to 1954 there were less than 1,000 words in the Internal Revenue Code concerning partnerships. The 1954 Code draftsmen developed Subchapter K which is a long and complex coverage of partnerships for tax purposes. The system followed was this. A general rule is first stated which follows the entity theory. Then if alternate rules are used (to permit wide flexibility for partnerships) the aggregate theory is used. So we have the general rules of the Code based upon an entity theory, and alternate rules based upon the aggregate theory.

This brings us to liquidation agreements. As stated, a liquidation agreement is one in which the continuing partnership liquidates or pays for or acquires the interest of a disabled, retiring or deceased partner. Hence you can see that this is an entity concept, for the partnership itself does the liquidating in its separate entity sense.

We will be concerned mainly with liquidation in the event of death or disability. However, there are liquidations on retirement. Under the Code the words "retirement of a partner" have a much broader meaning than they do in pension cases. If a 30-year-old partner withdraws from his partnership and lets the continuing partnership acquire or liquidate his interest, he is a retiring partner under the Code. It would include a liquidation because of disability or for any reason whatsoever.

But if a 65-year-old partner retains his interest in the partnership but spends all of his time in Florida or Spain, and does not participate actively in the firm's business, he is still a partner. He has not retired within the meaning of the Code unless and until the firm liquidates his interest, or unless he sells it to the other partners under a purchase and sale agreement.

Too often it may have been thought that all one must do is decide whether to liquidate an interest under the entity plan, or sell it under a cross purchase plan, and that thereafter everything would take care of itself.

Unfortunately, this is not true. The partnership section of the Code, Subchapter K, is probably one of the most difficult sections of the Code, and certainly one of the least understood.

There are reasons for this. First, the arrangement of Subchapter K is confusing. It does not move from the simple to the complex. A proposed Bill, H. R. 9662 will change this if it becomes law.

Secondly, in many cities there seem to be few mercantile or manufacturing partnerships. They are instead corporations. If partnerships exist, they are professional firms and they do not have all of the problems of firms that have large fixed assets and inventories.

Definition of Partnerships

Under the Uniform Partnership Act, a partnership is defined as follows: "A partnership is an association of two or more persons to carry on as co-owners a business for profit." And the word business includes "every trade, occupation or profession."

For Federal income tax purposes, the concept of partnership is much broader. Section 761 (a) defines a partnership as including "a syndicate, group, pool, joint venture or other unincorporated organization through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title a corporation or a trust or an estate."

The word "title" refers to Subtitle A of the Code which covers all Income Taxes including income taxes of individuals, corporations and partnerships.

Attributes of Partnerships

A partner owns his interest in the partnership as such. For most purposes he is not considered as owning this desk or that machine.

Under the Code partners may have equal or unequal interests in the capital of the firm. They may share profits in the same proportions or in different proportions. They may share profits without regard to their interests in the capital account. For example, three partners may have equal interests in invested capital or the capital account while at the same time they share profits in a 70%, 20% and 10% ratio, or in any other ratio.

Usually when a partnership is formed, there is no taxable event. Property or cash is contributed and each partner receives an interest in the firm.

However, if A invests $10,000 and B receives an equal interest for services rendered or to be rendered, it is possible under certain circumstances that B's interest, let us say $5,000 in this case may be taxable to B. It would not be if A were to get back his $10,000 on dissolution before B shared in the property. It may be if on dissolution A is to get $5,000 and B $5,000.

We may return to the entity and aggregate theories and see what effect they have taxwise.

The partnership may be a separate entity. It files an information income tax return, but it does not pay any tax. The partners

pay taxes as individuals (both entity and aggregate theories). It has its own taxable year. A partner may deal with the firm as if he were not a partner. And there are other examples which relate to adjustment of the basis of a partner or of partnership property. In other words, the theories do have tax consequences.

Liquidation Agreements

Perhaps the most important sections of the Code which deal with a liquidation agreement are Section 736 entitled "Payments to a Retiring Partner or a Deceased Partner's Successor in Interest," and Section 751 which deals with so-called "unrealized accounts receivables."

It must be remembered that 736 deals only with liquidation agreements. It has no application to cross purchase agreements.

Section 736 is divided into two parts, 736 (a) and (b). As so often happens in the Code, the Sections could very well be reversed.

Section 736 (a) provides that except as provided in (b), payments made in liquidation of the interest of a retiring or deceased partner shall be considered:

(1) As a distributive share of partnership income, if determined with regard to partnership income; or

(2) As a guaranteed payment if the amount is determined without regard to partnership income.

Then 736 (b) provides that to the extent that under the Regulations payments are made in exchange for the interest of a partner in partnership property, this is considered as if it were a distribution (of such property) by the partnership and is not to be considered as a distributive share of partnership income or as a guaranteed payment under 736 (a).

So far this is rather simple. Payments under (a) are going to be treated as ordinary income to the retiring partner or to a deceased partner's estate. Payments under (b) are not going to constitute income.

But then come two special rules—to the extent that any payment in liquidation is made for so called unrealized receivables as defined in 751 (c); or for good will except to the extent that the agreement provides for payment for good will—these payments will also fall under (a) and will constitute ordinary income.

Unrealized receivables are defined as goods delivered or to be delivered, to the extent that the proceeds received for such goods would be treated as amounts received from the sale or exchange of

property that is not a capital asset, or payment for services rendered or to be rendered.

Such goods would include inventory items, stock in trade. For example suppose the partnership was an engineering firm and had a contract to build a dam. The materials to be furnished would fall under 751. And payments for engineering services on the dam—services rendered and to be rendered would fall under 751.

Another example would be in a law firm that was handling a large anti-trust suit. It might have rendered services of $100,000 not yet paid and would still have services to be rendered of a possible additional $100,000. We may refer to all of this as Section 751 property.

We, therefore, have at least three or perhaps four classes of payments that can exist in a liquidation agreement.

Class 1. For property such as machines, building, equipment under 736 (b). (Not taxable as income to the payee.)

Class 2. A guaranteed payment or a share of profits under 736 (a). (Taxable as income to the payee.)

Class 3. Payment for good will. (Not taxable as income if reasonable and if provided for in liquidation agreement. Taxable as income if not mentioned in the agreement, and perhaps if the allocated amount is not reasonable.)

Note: With respect to good will, if not mentioned in the agreement there would be no specific allocation but by a process of elimination the Revenue Service would be able to allocate part of the payment to good will or else insist that it was a guaranteed payment. In either event it would be taxable to the payee.

Class 4. Payments for Section 751 property, unrealized accounts receivables. (Taxable to the payee under the special rules of 736 (b) (2).)

Example: Payment in liquidation of A's interest is made to his executor as follows:

Class 1. $50,000 for interest in property.

Class 2. Guaranteed payment of $5,000 a year for 5 years to A's widow.

Class 3. Payment of $10,000 for good will, mentioned in the agreement.

Class 4. Payment of $90,000 for A's interest in Section 751 property for goods and services rendered and to be rendered.

Income Tax Consequences:

The $50,000 for the property is not taxable to the estate.

The $5,000 a year for 5 years is taxable to the widow as income in respect of a decedent under Section 691.

The $10,000 for good will is not taxable to the estate since it is mentioned in the agreement. If it were not mentioned, it would be taxable.

The payment for $90,000 for Section 751 property is taxable to the estate.

The result is that the estate received $60,000 of non taxable payment, and $90,000 taxable as income, and the widow's payments of guaranteed income are taxable.

The taxable payments to the estate would be taxable as income in respect of a decedent which simply means that to the extent that the $90,000 increased A's estate tax, the estate would receive a deduction for income tax purposes (a deduction from gross income and not a credit against the tax).

For example, if the estate's income was $100,000, and if the $90,000 payment fell into the 30% estate tax bracket, or was additional tax of $27,000, this would be deductible from the $100,000 gross income of the estate. So if there were other total deductions of let us say $15,000, the estate would have taxable income of $100,000 less $27,000, also less $15,000 or $58,000.

From the standpoint of the surviving partners, the payments that are taxable to the estate are not taxable or includable as income by the surviving or remaining partners.

You can see that most partners will not realize that any such large amounts will be taxable as income to their estates or to them if they retire or withdraw.

In H.R. 9662, proposed new partnership law, the words "or to be delivered" with reference to goods, and "or to be rendered" with reference to services are deleted. This will eliminate part of the problem, if enacted, but payment attributable to services actually rendered or goods actually delivered will still be taxable as ordinary income.

The concept here is that the services have been rendered or non-capital goods sold, and if the partner had continued in the firm, his shares of such payments would have been taxable as ordinary income to him. By liquidating his interest he should not be allowed to change ordinary income into a capital transaction resulting in capital gain or in no gain if a stepped up basis occurs, as it otherwise would under Section 1014 following a partner's death.

Closing the Taxable Year

In a liquidation agreement if any payments are to be made or continued following the date of death, the taxable year of the partnership does not close (Sec. 706 (c) (2)). This is desirable if the partners as individuals have a different taxable year than the partnership. It prevents bunching of more than 12 months' income to the surviving partners.

But if the partners have the same taxable year as the partnership, it can result in a deceased partner's loss of deductions on his final return and possibly a loss of the right to split income with the partner's wife or widow. Under Regulation 1.706-1 (c) (3), this can be avoided as to the deceased partner by providing that the sale or liquidation and all payments take effect as of the date of death.

These are the basic problems in liquidation agreements. There are certain others, such as adjustment of basis of the interest of the deceased partner and interests of the surviving partners. Briefly, an election must be made by the partnership and then it is possible to increase or decrease the basis of certain partnership property. Since on death the partner's interest would usually be stepped up, under Section 1014, this could result in increasing the basis of certain partnership property. The Sections are 754 and 743.

Situations in Which Liquidations Are Used

In any case in which a partnership wants to have the agreement carried out through the continuing partnership, a liquidation agreement will be used.

It will often be to the advantage of the surviving or continuing partners to use a liquidation plan. Some of the payments may be placed under Section 736 (a) and they will be deductible or not includable by the surviving partners. In this way it may be possible to provide a larger liquidation payment.

However, if there are substantial amounts of Section 751 property, this can create a serious income tax problem, unless such payments are spread over a period of years.

If a partner becomes disabled, it may be provided that he will receive a reducing share of profits for a period of years, after which the continuing partnership may liquidate his interest. In such event, the payments may be made under Section 736 (a) which will be taxable to the disabled partner and not to the continuing partners.

If there are large amounts of unrealized receivables, it may be possible to avoid the income tax thereon by using a criss cross agreement. There may be a loophole in the law. The argument is that in

a criss cross agreement, as in a liquidation, the partner is selling his interest as such and that it takes a stepped up basis on death. And Section 743 (b) permits a step up to the extent the estate's basis, "for its partnership interest exceeds its proportionate share of the adjusted basis of the partnership property." Under 1014 the estate's value for its interest is its fair value or agreed purchase price at death. Such value includes the estate's interest in unrealized receivables unless such value constitutes income in respect of a decedent (Regs. 1.742-1). But the only reference to unrealized receivables being income in respect of a decedent is in Section 753 which refers only to Section 736 (a) payments. And 736 has no reference to a cross purchase agreement.

Some authors feel that this loophole exists. Others say that it does not and that the Courts would not go along with this. H.R. 9662 attempts to close this loophole. Whether it does or not is questionable.

In personal service and professional partnerships, liquidation agreements may be used combining Section 736 (a) and (b) payments. Here again receivables can constitute a problem.

In a two man partnership, for tax purposes and liquidation purposes, under the Regulations the partnership is considered as continuing as long as the deceased's estate is entitled to further payments under the Agreement, and until all payments have been made (Regs. Sec. 1.736-1 (a) (6)). Therefore a liquidation can take place in a two man firm.

Use of Life Insurance in an Entity or Liquidation Agreement

It is most important that life insurance be used in these agreements in practically every case. Mr. Willis in his *Handbook of Partnership Taxation* has pointed out the importance of life insurance as a funding device.

Since the partnership is to effect the liquidation, the policies should be owned by and made payable to the partnership.

A former problem that may have existed was eliminated by the 1954 Code. Life insurance proceeds are non-taxable. It was sometimes felt that because of this when the survivors acquired a partner's interest in a liquidation, the basis of their interests might not be increased. Hence on a later sale there might be capital gain, and in effect this would be taxing life insurance indirectly.

But Section 705 (a) (1) (B) of the 1954 Code provides that the partner's basis of his interest in the partnership is increased by his

distributive share of the tax exempt income. So there is no longer a problem in this area.

However, there is one problem to watch. Section 704 (b) provides that a partner's distributive share "of any item of increase, gain, loss, deduction or credit shall be determined in accordance with his distributive share of taxable income" unless the agreement provides otherwise.

Although 704 (b) refers to "taxable income" if it is held to refer also to tax exempt income, part of the proceeds could be allocated to the partner's estate for tax basis purposes.

In order to avoid any question here, it is or should be provided in the agreement that the proceeds will be allocated to the surviving partners only and that the partner's estate shall have no interest therein and no distributive share of the insurance proceeds.

The use of life insurance will not result in the proceeds being included twice in the estate. That is, both the proceeds and the purchase price will not be included in the estate *(Ray E. Tompkins*, 13 T.C. 1054 acq.).

In a liquidation the proceeds must be paid to the partnership and then through the partnership to the deceased partner's estate. This avoids any results such as the *Legallet* case, 41 BTA 294 (1940) where each insured owned his own policy and caused it to be payable to his wife resulting in a loss of cost basis to the surviving partner. There will be no problem if the proceeds are paid to the partnership.

Suppose we have a case where there is double indemnity or proceeds in excess of the value of the partner's interest. Let us say the value is $75,000 and the proceeds total $125,000. It is agreed that life insurance will be the minimum value. Here the $50,000 in excess of the $75,000 value would be a guaranteed payment under Section 736 (a) and would be taxable as income to the estate in a liquidation.

In any such case it would be better to use a cross purchase agreement and avoid this problem because Section 736 has no application to cross purchase agreements.

If it is desired to use a Trustee in a liquidation case, the proceeds received by the Trustee should probably be paid first to the partnership by the Trustee and then over to the estate through the partnership in order to comply exactly with Section 736.

Suppose it is desired to let the partnership own the policies but to use a criss cross plan. This could be accomplished by having the proceeds payable to the partners other than the insured.

If this is done, the cash value of the policy is considered as distributed to the surviving partners and this reduces their basis but does not result in any tax at that time.

Suppose that there are three partners, A, B and C, and A dies. B and C are to acquire his interest equally. The insurance on A is owned by the partnership but is payable to B and C. A dies and the price for his interest is $60,000 plus the assumption by the partners of $600 of A's share of partnership liabilities. This is not paid to A but for tax purposes it is part of his consideration. Assume the following facts:

	B 50% to be acquired	*C 50% to be acquired*
Original bases of interest	$15,000	$15,000
Less cash value of insurance distributed	4,000	4,000
	11,000	11,000
Cash paid to A's estate	30,000	30,000
Liabilities to which A's interest was subject	300	300
NEW BASES	$41,300	$41,300

This will explain the income tax accounting. (See *Willis, McDonald and Little,* 18 N.Y.U. Tax Institute, Page 1044 (1959).)

In speaking of using a criss cross plan, instead of a liquidation plan, if life insurance exceeds the value of the interest such as it might if double indemnity proceeds existed, Mr. Willis said:

> "The significant point is that tremendously different tax consequences can flow from one course of action than would result if a different procedure were adopted. *There will be a tremendous premium on a thorough knowledge of the income tax provisions relating to partnerships in transactions involving liquidations of the interest of a retiring or deceased partner.*"

Estate Tax Consequences

In these cases, the agreed value or purchase or liquidation price will constitute the estate tax value of the interest of the partner in the partnership. *Fiorito* v. *Com'r,* 33 TC, No. 51 (1959); *May* v. *McGowan,* 194 F (2d) 396 (2nd Cir., 1952).

If there are payments for unrealized receivables spread over a period of years, the discounted value of these payments will be includable in the estate.

In cases in which there is an agreement that the estate shall continue to share profits over a period and take no other interest, under *Bull* v. *U.S.,* 295 U.S. 247 (1935) it was held that no value would be included in the estate. However, since 1954 it is generally felt that the value of the right to receive profits would be includable and that the *Bull* case may no longer be law. See *Estate of Riegelman* v. *Com'r,* 253 F (2d) 315 (2nd Cir., 1958); *Winkle Exrx.* v. *U.S.,* 160 F. Supp. 348.

In no event will both life insurance and the agreed value be included. *Ray E. Tompkins,* 13 T.C. 1054 acq.; *Estate of Mitchell,* 37 BTA 1, acq.

PARTNERSHIP CROSS PURCHASE AGREEMENTS

Introduction

Cross Purchase Agreement is a convenient term used to describe an agreement between or among the partners as individuals as distinguished from a liquidation agreement carried out through the partnership.

For example, in the partnership consisting of A, B, and C, it is agreed that upon the death of any of the partners the surviving partners will purchase his interest in the partnership in equal shares.

Section 736 has no application to Cross Purchase Agreements. It applies only to liquidation agreements. Consequently the problems presented under 736, and the advantages thereof have no application.

The problems that can be met in a Cross Purchase Agreement will be discussed under various headings herein.

Types of Agreements

Agreements may provide for a lump sum payment, or for definite installments. When life insurance is used, all of the insurance to the extent required will be payable in a lump sum. If the purchase price exceeds the insurance proceeds, such excess will be payable over a period of years, payable in equal quarterly, semiannual or annual installments.

Use of Life Insurance

Since death of a partner is the event that causes the agreement to become operative, life insurance provides the most economical method of providing the purchase price. In this way the event that

makes it necessary to provide the purchase price, produces the purchase price.

Policies may be owned by and made payable to the partners other than the insured. In a three man partnership this would make it necessary to have six policies, a figure determined by multiplying the number of partners by a number that is one less than the number of partners. In a five man firm, the figure would be 5 x 4 or 20 policies. Since policies are often graded by size as to premium payments, it is often desirable to use fewer policies. In such event the policies may be owned by a Trustee, who may be one or more of the partners. In this manner in a three man firm there would be three policies only.

It is also possible to let the partnership own the policies and have them payable to the partners other than the insured. In this case upon the death of a partner, the proceeds would be paid to the surviving partners. Assume A, B and C partnership and A dies. B and C collect $50,000 each. The cash value of the policy as of A's death was, by assumption, $10,000. This amount is considered as a distribution from the partnership to B and C and would reduce their basis by $5,000.

Generally level premium whole life policies would be used. Preferred risk or preferred protector policies which are whole life policies with premiums reduced because of policy size are used most often. In some instances term or automatically convertible term policies are used. Policies which provide a face amount plus increasing term insurance, or whole life policies with a so-called fifth dividend used to purchase additional one year term coverage are sometimes used, especially if it is desired to borrow upon a policy to pay premiums and still have the face amount payable upon death.

Life insurance will not result in any double estate taxation. *Tompkins,* 13 T.C. 1054 acq. C.B. 1950-1 p. 5.

Closing the Partnership Taxable Year

The partnership taxable year closes upon the date of the deceased partner's death if the agreement to purchase his interest takes place as of the date of his death.

Reg. Sec. 1.706-1 (c) (3) (iv).

In such event the income of the firm received by the partner in the taxable year in which his death occurred must be reported in his final income tax return. If he is in a different taxable year than the partnership, this can result in a bunching of income in his final return. This results because of the requirement that a partner

or his successor in interest reports his distributive share of partnership profits or earnings in his tax return for any taxable year of the partnership ending within or with the taxable year of the partner (Sec. 706 (a)). This may be eliminated by continuing the estate as a partner for a period of months and then having the sale take effect at the end of this period.

When the partner and the partnership have the same taxable year, however, closing the partnership taxable year as of the date of death can result in lower income taxes because of the deductions and personal exemptions of the decedent, as well as the right to file a joint return if his spouse is living.

(See generally Reg. Sec. 1.706.)

If the problem is serious a liquidation may be used, since under the regulations an estate remains a partner until all payments due it have been received.

(Reg. Sec. 1.736-1 (a) (6).)

If the deceased partner's interest were less than a 50% interest in capital and profits, the partnership would not terminate and so the taxable year would not close as to the surviving partners.

(Sec. 708 (b) (1), 706 (c) (1).)

If the sale were of a 50% or larger interest in capital and profits, the partnership would terminate and the taxable year would close as of the date of sale for the surviving partners.

(Sec. 708 (b) (1) (B), Sec. 706 (c) (1).)

Again the surviving partners could prevent this by continuing the partnership with the estate, and having the date of sale occur after the date of the decedent's death.

Termination of the Partnership

As stated under IV, above, the sale itself will not necessarily terminate the partnership, but if the decedent's interest sold was a 50% or larger interest in capital and profits, then this will terminate the partnership.

(Sec. 708 (b) (1).)

This could result in the loss of a special fiscal year of the partnership which could only adopt a new fiscal year with permission of the Secretary.

(Sec. 706 (b) (1).)

This would not be true in a liquidation which is not a sale that terminates the partnership.

(Reg. Sec. 1.708-1 (b) (1) (ii).)

These questions of termination and closing the partnership year should be considered in drafting the purchase and sale agreement.

Basis of the Deceased Partner's Partnership Interest

The basis of the deceased partner's interest in the partnership is the fair market value thereof as of the date of his death (or at the alternate valuation date) increased by the estate's or other successor's share of partnership liabilities (if any) as of the same date and reduced to the extent that such value is attributable to items constituting income in respect of a decedent (Reg. Sec. 1.742-1).

In any case in which transfer was properly restricted during lifetime, the fair market value in a cross purchase agreement would be the purchase price (increased by the decedent's share of liabilities, and decreased by items constituting income in respect of a decedent). In a cross purchase agreement unrealized receivables may not be income in respect of a decedent (See Sec. 753 which refers only to Sec. 736, which does not apply to a purchase and sale agreement).

In a Cross Purchase Agreement assume a purchase price of $75,000 for A's interest. A dies. $35,000 is attributable to unrealized receivables and $8,500 attributable to good will. A's share of liabilities is $500.

In a liquidation agreement if good will is not mentioned in the agreement, A's estate's basis would be $75,500 less $43,500 or $32,000. If good will had been mentioned in the liquidation agreement it would have been $75,500 less $35,000 or $40,500.

In a Cross Purchase Agreement the basis may be $75,500 because of a loophole in the law, or it may be $40,500 if it is held that in a Cross Purchase Agreement that part of the interest that is attributable to unrealized receivables is income in respect of a decedent.

Unrealized Receivables in a Cross Purchase Agreement to Be Carried Out Upon a Partner's Death

Clearly in a liquidation agreement that part of the liquidation price that is attributable to unrealized receivables is income in respect of a decedent. Payments for amounts attributable to unrealized receivables are taxable under under Section 736 (a), and Section 753 provides that payments under Section 736 (a) are income in respect of a decedent.

This constitutes the only reference in the Code which designates unrealized receivables as income in respect of a decedent. And since this reference is to 736 (a), the Code reference in 753 cannot literally apply to a purchase and sale agreement since Section 736 applies only to liquidation.

It was clearly the intention of Congress that in a purchase and sale agreement that portion of the purchase price that is attributable to unrealized receivables should be considered income in respect of a decedent. This appears from Senate Report No. 1622 which provides that "the estate . . . will also be treated as receiving income in respect of a decedent to the extent that amounts are paid to him *by an outsider* in exchange for his interest in the partnership attributable to the value of the decedent's interest in partnership receivables." (Page 406.)

However, the statutory plan of referring only to Section 736 (a) in 753, resulted in an oversight or loophole.

If there is an election in force under Section 754 in the case of a transfer, the basis of partnership property will be adjusted under Section 743 (b). Under Section 1014 (a) the entire interest as such is being purchased and this takes a new basis under 1014 (a). This interest is not income in respect of a decedent, and so Section 1014 (c) does not apply. The receivables are merely a part of the entire interest. Even if the receivables would be income in respect of a decedent if held by the partner individually (for example as a sole proprietor) they lose that classification when held by the partnership when the purchase is of a partnership interest as such. Hence the value of the interest is its fair market value under 1014 (a) (in a purchase case the purchase price) and the receivables are not taxed as income; they are not income in respect of a decedent.

> See Willis, supra at p. 391; Willis, Little and McDonald, "Problems on Death, Retirement or Withdrawal of a Partner," 17 N.Y.U. Tax Institutes 1033 at p. 1039 and 1042; McDonald, Dohan and Phillips, "Taxation of Partnerships," American Law Institute, pp. 239-243.

It is proposed in H.R. 9662 to change this result, but the drafting in this bill may still leave the loophole.

It is assumed that because of the intention of Congress, expressed in the Senate Report, the Internal Revenue Service will insist that unrealized receivables are taxable as income, and there are authorities who feel that the loophole does not exist.

Bases of the Surviving Partners' Interests

The basis of or for each surviving partner will be increased by the amount that he pays for the deceased partner's interest plus the amount of the decedent's liabilities of the partner that he, the surviving partner, assumes. For example, in the firm of A, B and C, B and C pay $40,000 each to A's estate for A's interest and each assumes $300 of A's partnership liabilities. Prior to the purchase each had a basis of $30,000. The basis of each of B and C will be increased by $20,300 representing each one's share of the purchase plus the $300 liabilities assumed.

If B and C collect life insurance proceeds and use these in purchasing, they have received cash and the result is the same as above.

If the partnership owned the life insurance, for $80,000, and if it had a cash value of $20,000, and if the death proceeds were payable to B and C, then each would be considered as receiving $10,000 of the cash value which would reduce the basis of each by this amount, so the resulting basis instead of being $50,300 as above would be $40,300.

Partnership's Basis for Its Assets Following Purchase of Deceased Partner's Interest

If the decedent's interest is less than a 50% interest in profits and capital, then there is no change in the basis of partnership assets unless the partnership elects under Section 754 and 743 (b) or unless the surviving partners elect under Section 732 (d) to change or adjust the basis of partnership assets.

If the interest purchased is a 50% or more interest then there is a termination of the partnership in a purchase case. In absence of an election described above, the bases of the assets carries over to the new partnership.

If there is a purchase and an election is in force, and if one is made by the surviving partners, then the bases of partnership assets is increased in an amount equal to the basis of both surviving partners for their interests in the partnership over the basis of all of the partnership property. Allocations are made among the partnership assets as provided for in Section 755.

For examples of allocating and adjusting basis, see Willis, Little and McDonald, *supra*.

Gain or Loss to Deceased's Estate

If the partnership elects under Section 754 or if the estate elects under 732 (d) to adjust basis, then the deceased partner's estate will have neither gain nor loss. If no election is made and if there are

unrealized receivables with a zero basis, then the estate will have a capital loss.

If the surviving partners fail to adjust the basis of the unrealized receivables acting either under Section 754 or 732 (d) then when they receive payments for the receivables these payments will be taxable as ordinary income.

Assume unrealized receivables with a zero basis that amount to $28,000 which could be adjusted up to $28,000. If no adjustment is made there will be $28,000 of ordinary income. If the basis adjustment is made this will not result. If there were no loophole this would not result in the $28,000 escaping taxation since it would be taxed as income in respect of a decedent to the deceased's estate or payee.

Further Income Tax Considerations

In addition to unrealized receivables, Section 751 refers to inventory items which have substantially increased in value (751 (d)). If upon death an election is in force under Section 754, or if the purchase price is paid within two years of death, then the basis of the inventory items is, or can be, adjusted and there is no taxable income upon such increased inventories. If no such election is in force or made, income may result. (See Regs. Sec. 1.751-1 (b) (3).)

If in a purchase agreement a minimum purchase price is guaranteed, which exceeds the value of partnership property, such guaranteed payment is part of a capital transaction and the payment made for it is not deductible by the surviving partners. It is made with after tax dollars. It is not income to the estate or other payee. The result in a liquidation is exactly the opposite. If there is to be a large guaranteed payment resulting from insurance (including any double indemnity or additional death benefit insurance) then it will be to the estate's interest to have a purchase and sale agreement and not a liquidation.

Estate Tax Considerations

In a cross purchase or purchase and sale agreement, the purchase price will constitute the estate tax value if the agreement properly restricts transfer during the partner's lifetime.

> *Fiorito* v. *Com'r,* 33 T.C. 51 (1959); *Broderick* v. *Gore,* 224 F (2d) 892 (10th Cir., 1955); Regs. Sec. 20.2031-2 (b).

If the agreement were that the surviving partners would receive the deceased's interest in consideration of the payment to the estate of a share of prior and post death profits, the discounted value

of the payments to be received would constitute the estate tax value. *Riegelman* v. *Com'r*, 253 F (2d) 315 (2nd Cir., 1958); *Mandel* v. *Sturr*, 266 F. (2d) 321 (2nd Cir., 1959).

In *Bull* v. *U.S.*, 245 U.S. 247 (1935), the estate had the right to continue to share profits and losses for a year. The survivors had the option of discontinuing the partnership. It was held that the right to receive profits resulted in taxable income but that it was not a right to "corpus" and that no estate tax was payable. The basis for the decision is that the transaction was an income transaction. This case was decided before the statutory rule of income in respect of a decedent. The case has been explained on the basis of fact that the survivors could terminate at any time and hence the value of the right was not capable of valuation, but this does not appear to be the reasoning used by the Supreme Court. It is suggested in the *Riegelman* case that the *Bull* case may no longer be law.

In the case of an agreement to receive profits, such rights would be income in respect of a decedent and there would be a right to the deduction from gross income granted under Section 691. This would not be the usual cross purchase plan.

For a complete discussion of the problems, see "Income in Respect of a Deceased Partner" 19 N.Y.U. Tax Institute, p. 337-359.

Conclusions

The principal problems of purchase and sale or cross purchase agreements relate to those considered under this topic. A controversial question is present with respect to the treatment of unrealized receivables in a cross purchase agreement carried out upon the death of a partner. Whether a cross purchase or a liquidation agreement should be used will depend upon each situation and upon the intentions and wishes of the partners, and perhaps upon the knowledge of their legal counsel. The use of life insurance in a cross purchase plan will provide tax free funds that will be available to complete the agreement as of the date of sale.

DISABILITY PLANS

Without exception, close corporations are faced with the problem of what to do when a stockholder-employee becomes disabled, and must answer such questions as: How long can the business continue the salary of the disabled employee? How long can the business afford to pay for work not being done? How long will the non-disabled stockholder-employee be willing to carry the work

load of the disabled employee without hiring a replacement? How long can the business afford to pay the salary of the disabled employee and his replacement?

It is a fact that the hazard of disability is much greater than the hazard of premature death. Authoritative sources tell us that disabilities of ninety days or more are two to three times as frequent as death before age 65; that disability will strike fourteen and one-half million workers in the next ten years; and that long term disabilities average four years if disability commences at age thirty, four and one-half years at age forty, and five and one-half years at age fifty.

The Congress recognized in the 1954 Internal Revenue Code the need for employee disability coverage. Code Section 105 permits employers to establish accident and health plans for employees covering:—

1. Medical care expense of the employee, his spouse and his dependents (Section 105 (b)).
2. Payment for loss or loss of use of a member or function of the body, or permanent disfigurement of the employee, his spouse and his dependents (Section 105 (c)).
3. Wage continuation benefits while the employee is absent from work on account of personal injury or sickness (Section 105 (d)).

Furthermore, it is provided in Code Section 106 that the employer's contribution to the employee accident and health plan (through insurance or otherwise) is not included in the employee's gross income.

What then constitutes a "plan" within the meaning of these Code provisions? Must it be in writing, or in the nature of a trust? Must it be qualified with the Treasury and meet the non-discrimination tests applicable to qualified pension and profit-sharing plans?

The legislative history leading to the enactment of Section 105 will show that the House of Representatives initially intended that such accident and health plans should meet the same qualification tests applicable to qualified pension and profit-sharing plans, but that the Senate Finance Committee rejected this requirement and the law was enacted without any such standards. Senate Committee Report, 83rd Congress, 2d Sess., S. Rep. No. 1622 (1954) 183. Treasury Regulation 1.105-5 provides:

> "In general, an accident or health plan is an arrangement for the payment of amounts to employees in the event of personal injuries or sickness. A plan may cover one or more em-

ployees, and there may be different plans for different employees or classes of employees. An accident or health plan may be either insured or non-insured, and it is not necessary that the plan be in writing or that the employee's rights to benefits under the plan be enforceable. However, if the employee's rights are not enforceable, an amount will be deemed to be received under a plan only if, on the date the employee became sick or injured, the employee was covered by a plan (or a program, policy, or custom having the effect of a plan) providing for the payment of amounts to the employee in the event of personal injuries or sickness, and notice or knowledge of such plan was reasonably available to the employee. It is immaterial who makes payment of the benefits provided by the plan. For example, payment may be made by the employer, a welfare fund, a State sickness or disability benefits fund, an association of employers or employees, or by an insurance company." Cf. Senate Committee Report, 83d Cong., 2d Sess., S. Rep. No. 1622 (1954) 185.

Before answering the question of whether the employer's contribution or insurance premium payments are deductible, the income tax consequences of the benefits received by the employee under such a Section 105 plan should be reviewed. Subject to Code Section 213, regarding an individual's medical care expense, benefits received by the employee for himself or his dependents are not included in the employee's gross income. Benefits received for loss of limb, or sight, or permanent disfigurement, are wholly excluded under Section 105 from the employee's gross income. Wage continuation benefits, which are of primary concern for the purposes of this paper, may be excluded under Section 105 (d) from the employee's gross income up to $100 per week. Any amount received under an employee wage continuation plan in excess of $100 per week is taxable as earned income.

It should be noted that the $100 per week wage continuation exclusion is subject to a seven calendar day elimination period if absence from work is due to sickness which does not require at least one full day of hospitalization. Reg. 1.105-4 (a). If absence from work is due to sickness which requires hospitalization, or is due to injury, the $100 per week exclusion is applicable commencing on the first day of absence from work on account of such disability.

Although it has been said that the plan need not be in writing, Reg. 1.105-5 provides that if the employee's rights are not enforceable, an amount will be deemed to be received under a plan only if,

on the date the employee became sick or injured, the employee was covered by a plan and notice or knowledge of such plan was reasonably available to the employee. It is for this reason that it is generally recommended that the employer evidence the plan in some formal way, such as by a Board of Directors' resolution.

While most insurance companies will not write disability income policies for amounts greater than $100 or $125 per week, an employer can, if so desired, insure amounts up to this figure and make up the difference of the employee's usual salary from its own funds. The tax-free amount to the disabled employee is limited under Section 105 to $100 per week in any event.

There is no limit on the period during which such wage continuation benefits can be paid, so long as they are being paid during periods of absence from work on account of personal injury or sickness. Reg. 1.105-4 (a) (2) (i). After the employee's normal retirement date, however, the Treasury will not consider such wage continuation benefits as being made on account of disability. Reg. 1.105-4 (a) (3) in effect provides that if an employee is not expected to work after he reaches retirement age no part of the payment he receives thereafter is excludible under Code Section 105 (d).

In the recent case of *William L. Winter*, 36TC-, No. 2, the employer had an accident and health plan under which an employee would receive wage continuation payment during a period of absence from work on account of personal injury or sickness in addition to a pension plan which required retirement at age 65 but which allowed an early retirement date for reduced benefits at age 60. The employee, Mr. Winter, was disabled when he was age 58 and remained so disabled. The Commissioner allowed the sick pay exclusion up to age 60 but denied the exclusion thereafter upon the theory that Mr. Winter had reached retirement age because he could voluntarily retire at age 60. The Tax Court ruled in favor of Mr. Winter and held that the "sick pay" exclusion could continue to run during disability until he reached the compulsory and customary retirement age of 65. The Court noted that the amount of the pension at age 60 was generally less than at age 65 and that over a period of ten years only a small percentage of employees had exercised the option to retire at age 60.

The tax question which has caused the most difficulty is whether the premiums paid by the employer for the individual disability insurance policies funding the employee accident and health plan can be deducted as a business expense? As in the case of most other employee fringe benefits, the Internal Revenue Code does not specifically provide that such premiums are deductible. If they are

deductible, they must be deducted as an ordinary and necessary business expense under Code Section 162 (a). Revenue Ruling 58-90, C.B. 1958-1, 88, is, however, a most important ruling in answer to this question of premium deduction.

One of the factual situations involved in Rev. Rul. 58-90 was that of a corporation which purchased an individual insurance policy for a key employee. The only benefit provided by the policy was income replacement payments in the event the employee became sick or disabled. The employee had all the rights of ownership in the policy and no part of the benefits were payable to the corporation. The corporate employee paid the premiums only so long as the employee remained in its employ.

The ruling held that since the corporation was not directly or indirectly a beneficiary under the policy, the amount it paid as premiums could be deducted by the corporation as an ordinary and necessary business expense under Section 162 (a) of the Internal Revenue Code of 1954, or Section 23 (a) (1) of the 1939 Code, if it could be shown that the premiums were paid in connection with personal services actually rendered by the employee, and that the total amount paid the employee, including the premiums, was not unreasonable compensation for his services.

The ruling further held that the premiums paid by the corporation should be excluded from the gross income of the employee for the years to which Section 106 of the 1954 Code was applicable, but that for prior years such premiums should be included in the employee's gross income.

Rev. Rul. 58-90 could not have been more satisfactory—except for one very important fact. The employee involved was not a stockholder! This fact and the fact that the Internal Revenue Service did not volunteer an answer covering the stockholder-employee case has caused some tax advisors to question whether the results would have been the same if the employee had been a stockholder, and particularly if the wage continuation plan had been established for a controlling stockholder-employee only.

On April 17, 1961, the Internal Revenue Service announced that it had included the question of whether "the stockholder-employee may exclude from his gross income, under the provisions of Code Section 106, amounts paid by the corporation to provide accident and health benefits to the stockholder-employee" in the listed area in which the Service would no longer issue blanket rulings. Announcement 61-37, IRB 1961-16. A spokesman for the Internal Revenue Service has been quoted as saying that if a stockholder-employee thinks he is entitled to exclude such premiums from his

gross income he may so claim on his tax return or query the Service in advance and that the Service will investigate the claim for exclusion, perhaps even have an auditor check the situation, and decide each case individually.

It therefore appears clear from this announcement that the exclusion will not be denied the stockholder-employee in all cases and that if the wage continuation plan is intended as a bona fide plan for a stockholder-employee active in the business the premiums will be allowed to be deducted by the employer without being taxable to the stockholder-employee. As a corporation can continue the salary of a stockholder-employee during disability, the fact that the plan is funded by insurance should not make any difference for tax purposes.

An insured Section 105 plan can therefore be a solution to the corporate-employee disability problem, for under such a plan the corporation can be relieved of much of the financial burden of continuing the salary of the disabled employee, and corporate funds can be used to pay a replacement thereby relieving the work load of the non-disabled employee.

An insured Section 105 wage continuation plan can be integrated with a mandatory or optional purchase agreement whereby the non-disabled stockholder would purchase, or have the option of purchasing, and the disabled stockholder would sell his stock in the corporation after disability continued beyond a specified number of months. The purchase price could be paid, or partially paid, by the insurance disability benefits if the Agreement were so worded. Any additional purchase money could be paid by a series of notes, or could be made available from the cash values of the life insurance policies funding a Stock Redemption or Stock Purchase Agreement unless it is deemed advisable to keep such insurance in force to cover the death of the insured stockholder before the purchase price has been fully paid.

The basic problems of the disability of a partner are the same as for a stockholder-employee of a close corporation. The solution for the disabled partner, however, is not the same, as Section 105 wage continuation plans are not available to partners since they are not considered to be "employees" within the meaning of the Internal Revenue Code. See Rev. Rul. 58-90, supra. Partnerships can establish a Section 105 accident and health plan for its employees, but as in group life insurance, the partners themselves cannot be included and have the tax benefits of Section 105 and 106. Rev. Rul. 56-326, C.B. 1956-2, 100.

A partner must generally provide his own disability insurance

plan for loss of earnings and medical care. Disability coverage is a most important economic necessity for all people, including attorneys, who must live and provide for their families on earned income, regardless of the tax considerations. In such cases, the rules of personal insurance under Code Section 104 (a) would apply.

Partnership Agreements covering the problems of disability are becoming popular. Such agreements generally provide that the partnership will pay the premiums for insurance policies which will provide a specified amount of disability income benefits to a disabled partner. Further provision is generally made that after disability continues for a certain period of time, the share of profits or guaranteed income which the partner is usually entitled to receive will be reduced, and the non-disabled partner's share of profits or income will be increased to compensate him for the extra work and responsibilities which he must assume in the absence of the disabled partner. The reduction in the disabled partner's income is made up by the disability insurance policy benefits. Such agreements may also provide the partnership or the non-disabled partners with the option to purchase the disabled partner's interest in the business after disability continues for two or three years, as it is unlikely that he will ever return to his business after such a period of time.

Such partnership disability agreements present no special tax problems while the disability benefits are being paid, as the insurance policies are really personal insurance and the disability benefits are income tax free under Code Section 104 (a). Any payment made from the partnership to the disabled partner out of profits is in the nature of a distribution of income and is, therefore, taxable to him as it was prior to disability.

If such agreement does contain an option to purchase the disabled partner's interest, and if such option is exercised, the resulting tax consequence will depend upon whether such interest is acquired or liquidated by the partnership, or is purchased by the remaining partners.

If the partnership acquires or liquidates the disabled partner's interest, then special consideration must be given to Code Section 736 (a) and (b) regarding guaranteed payments. Section 736 (a) purchases will permit guaranteed payments by the partnership over a period of years to be deducted by the partnership under Section 162 (a) and taxed to the disabled partner as income under Section 61 (a). The basis for the partnership interests of the remaining partners, however, is not increased. Reg. 1.736-1 (a) (4). Section 736 (b) purchases are deemed to be payments made in exchange for an interest in partnership property and hence are a capital transaction taxable as

a capital gain, with two exceptions: (1) unrealized receivables, as defined in Section 751 (c), are exempted from capital gain treatment, and (2) good will must be specifically mentioned and payment provided for it in the agreement if it is to qualify for capital gain treatment. Reg. 1.736-1 (b) (3).

Section 736 has no application to the case when the partners, as individuals, purchase the interest of the disabled partner. Purchases by the remaining partners, or by outsiders, of the partnership interest of a disabled partner are taxed as any other sale would be.

USE OF SETTLEMENT OPTIONS

Stock redemption or stock purchase cases arise in which it is felt desirable to have the redemption or purchase price paid directly by the insurance company to a beneficiary or beneficiaries under the insurance policy used to fund the agreement under settlement or installment options.

There are two definite views concerning this held by lawyers and others. One holds that settlement options should never be used in such agreements both because of tax and substantive law considerations. The other holds that it is possible to use settlement options without unfavorable tax or substantive law results in any case in which their use may be desirable after taking into consideration all of the facts in any given case.

Those who object to using settlement options have made such statements as the method presents "an obvious inconsistency," the plan is "a testamentary disposition." If the purchase price is not to go to the estate, the sale could be held "not to have been entered into in good faith from the beginning." It is rather interesting to note that most of the cases cited by the writers of such statements to support their position are actually cases in which payments did go directly to a wife or to another third party, and also are cases in which no payments whatsoever were required, and in which the surviving partner or associate acquired the business interest without being required to make any payment for it.

See *Hale* v. *Wilmarth*, 274 Mass. 186, 174 N.E. 232 (1931);
Murphy v. *Murphy*, 217 Mass. 233, 104 N.E. 466 (1914);
Ireland v. *Lester*, 298 Mich. 154, 298 N.W. 488 (1941);
Silverthorne v. *Mayo*, 238 N.C. 274, 77 S.E. (2d) 678 (1953).

In view of the Massachusetts decisions and of the reasoning in *National Shawmut Bank* v. *Joy*, 315 Mass. 457, 53 N.E. 2d 113 (1944), there is no support for such arguments in Massachusetts from the standpoint of testamentary disposition or legal validity.

If it is argued that the Massachusetts contract law with respect to third party beneficiaries could be troublesome, the agreement may be placed under seal so that the law of covenant will control (*Matheis* v. *Corliss,* 103 Mass. 568; *Saunders* v. *Saunders,* 154 Mass. 337, 28 N.E. 270, and Restatement of the Law of Contracts, Massachusetts Annotations, Vol. 1, Pg. 66 (1935)), or the offer may be made a continuing offer to the third party beneficiary which when accepted by him or her will become irrevocable.

The options are of four basic types: (1) installments for a fixed period, (2) installments of a selected amount until the proceeds with any accumulated interest are exhausted, (3) an annuity for life with or without a guarantee for a stated number of years such as 5, 10, 15 or 20, usually called "years certain," and (4) proceeds left at interest with or without a right or withdrawal. There are variations of these basic options. Usually policies provide that one option only may be selected, but by Company practice, a combination of options may be used.

Whether or not the use of settlement options is desirable in any stock purchase or redemption case should be considered in concrete and specific cases rather than as a general or abstract question except insofar as the question of legal validity and tax considerations are concerned. There are situations in which the estate will require the purchase price for estate purposes. There are cases in which disgruntled heirs may cause serious objections and expensive litigation even if they do not prevail. But there are other cases in which no such objections exist.

With respect to legal validity, the cases cited hereinbefore make it clear that such plans are not invalid as testamentary dispositions in Massachusetts.

With respect to tax considerations, the necessity of making payment to the corporation in a stock redemption case and then over to the estate in order to avoid insurance premiums from being taxed as income to the insured-stockholder has been stressed. These statements resulted largely from the *Casale, Prunier* and *Sanders* cases, mentioned hereinbefore, each of which was reversed in favor of the taxpayer. It is clear from the *Sanders* case and from Revenue Ruling 59-184 (C.B. 1959-1, p. 68) that the use of settlement options will not result in premiums being taxable to the stockholder. This ruling provides in part that premiums "do not constitute income to any stockholder even though the stockholder has the right to designate a beneficiary, if such right of the beneficiary to receive the proceeds is conditional upon the transfer of the corporate stock to the corporation . . ."

With respect to the surviving stockholders, whether or not the redemption by the corporation will constitute a dividend to them cannot depend upon whether the estate of the deceased or a third party receives the redemption price. The sole question here is whether the corporation acquired the stock for itself or whether it purchased shares for the surviving stockholders. See *Holsey* v. *Com'r*, etc., supra.

In partnership cases there could be problems if settlement options were used. For example, in a liquidation under Section 736 of the Code payments must come from the partnership itself. And the *Legallet* case, 41 B.T.A. 294 (1940), possibly could present a basis question, unless procedures were taken to avoid the effect of the *Legallet* decision.

One of the reasons for using settlement options might be to provide a life income for a widow and to deny the right to commute or assign. If so, the consent of the wife should be obtained. Compare *Bolles* v. *Toledo Trust Company,* 144 Ohio St. 195, 58 N.E. (2d) 381 (1944). But even if consent were not obtained, in absence of fraud it is believed that the widow could not set aside the agreement in Massachusetts. Compare *Redman* v. *Churchill,* 230 Mass. 415, 119 N.E. 953 (1918), and see Leach, Cases and Text on the Law of Wills, 2d Ed. (1949), Chapter II, "Protection of Widow."

Cases that have been brought by widows indicate the desirability of obtaining the wife's consent if this is possible.

The question of rights of creditors should be considered, especially in partnership cases. Conceivably if cash values were carried as an asset as they generally would be, and if death caused this asset to disappear, a creditor might argue that he was prejudiced. If this situation may exist, the use of options is probably not desirable, but this is not the usual situation. If it were, in a corporation case, there would not be a redemption agreement. If any agreement existed, it would be a cross purchase agreement.

In partnership cases the problem of creditors may be more serious.

With respect to these questions generally and for a more complete discussion see Laiken, "Settlement Options and Survivor Purchase Agreements," the C.L.U. Journal for June, 1950, and MacKay, "The Use of Settlement Options in Business Insurance Cases," the C.L.U. Journal for December 1955.

The possibility of the purchaser being liable as a transferee for unpaid estate taxes must be considered. The Treasury Department could reach the proceeds for the payment of Federal estate taxes,

notwithstanding that the law is contra with respect to income taxes in absence of a lien. (I.R.C. Sec. 6901 (h), 6324 (a) (2) and 2042, Hill, Transferee Liability, 17 N.Y.U. Tax Institute 25 at page 31 (1959).)

In any case, provision should be made for the payment of all death taxes, costs and liabilities and it is assumed that no plan to use settlement options will be made unless and until these steps have been taken and adequate provisions for such payment has been made.

With respect to procedures, in any case it may be provided that the purchaser, including a corporation, may hold the proceeds under the interest option with a right of withdrawal for a period of a year or two years. Upon the release of the executor of the estate and upon acquisition of the stock or bill of sale of a partnership interest, the purchaser will release its interest in and to the proceeds which will then be held for the secondary or contingent beneficiaries under the settlement options placed in force during the insured's lifetime.

In any such case if the consent of the executor is required, then he should be empowered and directed to give such consent.

An alternate plan would be to place the stock in a living revocable trust and direct the trustee or successor trustee to deliver the stock to the purchaser upon the release of the purchaser's interest in and to the proceeds and the agreement of the insurer to hold the proceeds in accordance with the provisions of the settlement option agreement or request.

It is not possible in any option agreement to obtain the same flexibility that can result from the use of a trust of the proceeds. If such flexibility is required, a trust should be used. It is possible to provide for payments to a widow, for example, for a period of years or for life, with any proceeds remaining upon her later death to be paid over to a trustee for the benefit of children or others, thus obtaining the annuity option for the widow plus the flexibility of a trust for the children or other persons. All of the practices available when options are used in personal insurance cases will be available if options are used in any business situation.

Conclusions: Whether or not the use of settlement options is desirable can only be determined after a careful analysis of all of the facts in any case. If after such analysis it is decided to use settlement options, such use may be made without unfavorable substantive law or tax considerations.

If flexibility is required, a trust should be used. A combination of an annuity option plus a contingent trust is possible.

If the stock purchase or redemption or other business purchase agreement is executed as a sealed instrument, the law of covenant prevails in Massachusetts and any person living at the date of the agreement will have a direct right under the law of covenant.

In no event should settlement options be used except as a part of a carefully considered over-all estate plan.

SUMMARY

It is difficult to summarize a paper of this length other than to emphasize that it is a fact that the death or disability of a business associate can present serious problems to a close corporation or to a partnership, and that these problems can be greatly minimized by a properly drafted, insurance-financed sale and purchase agreement and disability insurance plan.

Remanded Cases

By HON. ARTHUR T. GARVEY

The author is Judge of the District Court of Western Hampden, a full-time justice since July of 1957, and a member of the Appellate Division for the Western District. He has consistently presided at remand sessions, and trials by jury of six, at the Central District Court in Worcester. For a substantial time he served, by assignment, at motor tort and misdemeanor sessions of the Superior Court.

Present Operation of the Statute

On September 1, 1958, the remand act, so called, G. L. (Ter. Ed.) c. 231, § 102C, became effective. It was enacted "to assist in solving the problem of congestion in the Superior Court." It permits the Superior Court, if "there is no reasonable likelihood that recovery will exceed $1,000.00" to "transfer" to a District Court "for trial any action of tort or contract," with the right of retransfer and trial in the Superior Court. The District Court is not limited to $1,000.00 in assessing damages. "The decision of, and the amount of damages assessed, if any, by a district court shall be prima facie evidence upon such matters as are put in issue by the pleadings, and no other findings of such court shall at any time be admissible as evidence or become part of the pleadings." *S. Albertson Co.* v. *Great Northern Railway Co.,* Mass. Adv. Sh. (1961) 535, 173 N.E. 2d 267. Except for the absence of a report of facts found, it is similar to actions referred to an auditor, facts not final.

Rule 33A promulgated by the Superior Court to implement this statute, requires a plaintiff within two months after joinder of issues to file a statement of expected damages. Failure to file may be taken to mean the plaintiff does not expect to recover more than $1,000.00. In practice, plaintiffs by not filing a statement, invite transfer. Displeased plaintiffs are filing discontinuances. Defendants do not seem to have the right to be heard on the matter of discontinuance before trial.

During the court year ending June 30, 1960, 3,600 cases, exclusive of those transferred to the Boston Municipal Court, have been remanded to District Courts. A greater number will be remanded this year. A thousand cases, about twenty-five per cent of the current court year's entries in the Superior Court for Worcester County, have been transferred to the Central District Court of Worcester. Available statistics indicate approximately fifty per cent of these cases are motor tort, twenty-five per cent other tort, and twenty-five per

cent contract. Not more than three per cent have been retried in the Superior Court.

All concerned with its operation think, with amendments, it is a workable statute. Many cases are tried, settled or otherwise disposed of within six months of entry in the Superior Court. Some trial lawyers prefer it to the auditor system. Some advocate that the amount of damages expected to be recovered should be increased to $2,000.00.

The Lubbell Case

From the beginning, it was recognized by District Court judges that the statute did not provide for any specific form of review. Thus, a decision, made in error, being "prima facie evidence," would warrant a finding for the prevailing party, and could prohibit directing a verdict for the adverse party. Review, it was felt, could and should be had in the Superior Court. Consequently, they unanimously refused (a) to accept and act on requests for rulings of law, and (b) dismissed claims of report to the Appellate Division based on such refusal. The Supreme Judicial Court, in *Lubbell* v. *First National Stores, Inc.*, Mass. Adv. Sh. (1961) 351, 172 N.E. 2d 689, a food products liability action, appealed by the defendant, decided that they were wrong. District Courts are now required to act on requests and to allow proper reports.

The Court, by Wilkins, C. J., reasoned that, otherwise, a party in the Superior Court would be "shackled with a decision which is prima facie evidence and with a dubious record from which to base arguments upon questions of law" and expressed "reasonable fear that there might be a denial both of due process and of the equal protection of the laws because of discrimination in according the right of review." The case was ordered returned to the District Court for further proceedings.

This decision also implies that the parties return to the District Court from the Appellate Division for such further proceedings as are necessary, and then to the Superior Court for retrial, before being permitted to appeal to the Supreme Judicial Court. The remedy for a party aggrieved by the Appellate Division decision is not made clear.

The *Lubbell* decision solved troublesome questions, but created others. Procedural problems have already arisen in the District Courts. For instance, the aggrieved party makes a timely request for a report to the Appellate Division and also files a request for retransfer. The act provides upon request for retransfer the case "shall be forthwith transmitted" to the Superior Court. Some judges, in

this situation, have ruled that the District Court loses jurisdiction, and dismiss the claim of report. Others hold that the request for retransfer operates after decision by the Appellate Division. The Act provides that request for retransfer must be filed within ten days of receipt of the notice of decision by the District Court. There is no provision for such request after an Appellate Division decision.

The Act now limits the Superior Court to the District Court "decision . . . and amount of the damages assessed, if any," and "no other findings of such courts shall at any time be admissible as evidence or become part of the pleadings." Are findings of fact and rulings of law, if made, admissible in the Superior Court? Is the Superior Court bound by the decision of the Appellate Division?

Proposed Remedy

Amendments to the act are needed. It is to be remembered that these are Superior Court actions to which court the parties have the right to ultimately return for trial. Having an interlocutory decision by an intermediate appellate court, of doubtful binding force on the Superior Court, the possibility of a second trial in the District Court, a second report to the Appellate Division, another trial in the Superior Court, with the right of appeal to the Supreme Judicial Court for a final answer, does not appear to be practical. It is a circuitous route, difficult to follow.

It would seem advisable to amend the statute to provide for review in the Superior Court. Chief Justice Wilkins, in the *Lubbell* case, said: "The only other possibility would be, as suggested by the Appellate Division, action by the Superior Court on retransfer. But no clear provision appears in 102C for the consideration there of such questions." The act, by amendment, could provide that the draft report go to the Superior Court for action instead of to the Appellate Division. There the court, as it now does with reports of auditors, could: (1) find no error, (2) find error and reject the decision, (3) strike findings of fact not based on the evidence, (4) strike erroneous rulings of law, (5) remand for further findings, (6) correct errors by instructions to the jury.

For consideration by the bar, the following is suggested. Changes in the present form of the statute are italicized. Suggested deletions from the present form of the statute are in parentheses.

Draft of Suggested Remanding Statute

"The superior court may of its own motion or on the motion of a plaintiff or defendant, after determination by said court that if the plaintiff prevails, there is no reasonable likelihood that re-

covery will exceed one thousand dollars, transfer for trial any action of tort or contract pending in said court to the court from which such action was previously removed, if any, or if such action was originally entered in the superior court, to any district court, including the municipal court of the city of Boston, in which it could have been brought under the provisions of section two of chapter two hundred and twenty-three.

"Clerks of the superior court shall, when a case is so transferred, transmit the order of reference and the original papers in the action, or certified copies thereof, together with a copy of the docket entries, without charge to the clerk of the court to which such action was so transferred.

"Such action shall, unless retransferred as hereinafter provided, be pending in the district court and shall be tried by a full-time justice of the district court or by a justice authorized for such service in accordance with section seventy-seven A of chapter two hundred and eighteen. The parties shall have the benefits of and be subject to procedural rules of such district courts relative to interrogatories, specifications, amendments, *requests for rulings of law* and all other procedural matters regulating cases pending in such district courts. The justice shall file a written decision *and his findings of facts, if any,* with the clerk who shall forthwith notify the parties or counsel of record. Any party to the action aggrieved by the finding or decision may as of right have the case retransferred for determination by the superior court, *and any party aggrieved by any ruling on a matter of law may as of right have the ruling reported for determination in the superior court in the same manner as is now provided for reports to the Appellate Division under the provisions of section one hundred and eight of chapter two hundred and thirty-one.* The request for retransfer shall be filed with the clerk of said district court within ten days after notice of the decision or finding, *or within such further time as the court may allow.*

"If either party neglects to appear at the time appointed for such trial, or at any adjournment thereof, without just cause, or if at any such time either party refuses to produce in good faith the testimony relied on by him, the justice may close the trial and order that judgment to entered for the adverse party and file a finding or decision to that effect, and if both so fail to appear he may order that the action be dismissed *no further action to be commenced for the same cause of action.* Judgment shall be entered accordingly at the first judgment day after the expiration of ten days from the filing of such finding or decision or order of dismissal, unless said justice for cause shown otherwise orders.

"Upon the filing with the clerk of a request for retransfer, the decision (or finding,) *and findings of fact, if any,* shall be forthwith transmitted, with any original papers received from the superior court and any original papers filed in the district court after transfer of the case by the superior court to the clerk of the superior court of the county from which the case was referred, *and when a draft report is filed by an aggrieved party upon its allowance, disallowance or dismissal.* The clerk of the superior court shall forthwith notify the parties or counsel of record of the receipt and filing of said finding or decision.

"The action shall thereafter be tried in the superior court, *but the court at the trial shall exclude any finding of fact which appears in a report to be based upon an erroneous opinion of law, or upon inadmissible evidence.* The decision of, *the facts found, if any,* and the amount of damages assessed, if any, by a district court shall be prima facie evidence upon such matters as are put in issue by the pleadings (and no other findings of such court shall at any time be admissible as evidence or become part of the pleadings). A party shall be held to waive any right to jury trial previously claimed, unless within ten days after the filing of the finding or decision in the superior court he shall file a statement that he insists on a jury trial.

"No action shall be discontinued, nor shall the plaintiff in such action become non-suit after the action shall have been transferred to the district court for trial, except with the written consent of the defendant or in the discretion of the court."

Federal Judicial Selection — Progress and the Promise of the Future

By BERNARD G. SEGAL of the Philadelphia Bar

This article is from a speech delivered at a meeting of the American College of Trial Lawyers on March 28, 1961, in New Orleans. The author is Chairman of the Standing Committee on Federal Judiciary of the American Bar Association. We present the article without comment—for it needs no preliminary recommendation—but we suggest that the reader who is not inclined to read the entire presentation, should at least peruse the last three paragraphs of the article.

To President Kennedy will fall, in this year of 1961, the responsibility of appointing more judges to the Federal Bench than any other President in our whole history has named in an entire term of four years. If legislation already passed by the Senate and presently pending in the House is enacted into law, the total number of President Kennedy's appointments this year may well amount to 125 judges—fully one-third of all the judges on the Federal Bench today.

The question whether in the filling of these important life-time judgeships, the processes of our political system will work at their finest, fulfilling the highest aspirations of the people, and securing none but the best qualified lawyers and judges for the Federal Bench, will be answered in largest part by the determination of the President and his advisers. But another, and a not inconsiderable factor, will be how active, how effective the lawyers of the Country will be, through the Organized Bar in all its segments, in helping secure the most qualified persons available for these appointments; how determined, how militant they will be in counteracting the pressures sometimes exerted in behalf of lawyers not qualified to serve on the Federal Bench.

The role of the American Bar Association in the matter of the appointment of Federal judges commenced in 1945. In that year, the Association created for the first time, a Special Committee on Federal Judiciary. This Committee was successful in quickly establishing a cordial relationship with the Judiciary Committee of the United States Senate. The Chairman of the Senate Committee made it a practice, which succeeding Chairmen have continued, to notify the Chairman of the ABA Committee whenever there was to be a hearing on a judicial nomination. The ABA Committee was thus afforded an opportunity to advise the Senate Committee of its collective opinion on the nominee's qualifications.

In two notable instances in those days, the strong objections of the ABA Committee, backed by evidence vigorously presented at public hearings of the Senate Subcommittee, resulted in Presidents withdrawing the nominations and submitting other more qualified nominees instead. A Fellow of this College, John G. Buchanan, was Chairman of the ABA Special Committee at that time. He conducted the investigation and presented the evidence before the Subcommittee in one of these cases.

From 1945 to 1952, the ABA Committee made repeated efforts to establish a similar relationship with the Attorney General, but it was completely unsuccessful. The channels of communication from the Attorney General to the Committee were practically nonexistent. Under these circumstances, the Committee followed the only procedure available to it. When it knew of a vacancy, it canvassed the judges and lawyers of the particular community and sent to the Attorney General a list of qualified persons available for appointment. Often, however, before the Committee had an opportunity to complete its canvass, the nomination had already been made. And in numerous other cases, the Committee's first information of the existence of a vacancy came from the public announcement that the President had sent a nominee's name to the Senate. It hardly seems possible that this was the situation as recently as eight years ago.

In August, 1952, a notable step forward was taken. Ross L. Malone, a Fellow in this College, had just been appointed the Deputy Attorney General of the United States. Promptly thereafter, he entered into an agreement with the ABA Committee that he would submit to the ABA Committee for its investigation, report, and recommendation, the name of each prospective judicial nominee. This was to be done simultaneously with the submission to the Federal Bureau of Investigation, which traditionally had conducted investigations prior to any nomination. As it happened, there were no judicial nominations during the short period of President Truman's term which remained, but Mr. Malone's agreement represented an important principle, officially pronounced, and a blueprint for future development.

Attorney General Brownell and Deputy Attorney General Rogers, with President Eisenhower's approval, put the system into effect immediately after they assumed office in 1953. There was one modification. Mr. Brownell suggested that the Committee's influence would be more persuasive and its reports less suspect of partisanship in behalf of any individual, if it discontinued its practice of proposing names of indivduals when vacancies occurred. The

Committee readily adopted Mr. Brownell's recommendation, and since then, the ABA has scrupulously avoided initiating any nominations.

Step by step, appointment by appointment, the program developed during Mr. Brownell's tenure as Attorney General, and later during Mr. Rogers' when Judge Walsh became the Deputy Attorney General.

During the eight years, there were of course many problems and numerous difficulties, but there were remarkably rapid advances, too.

A word about the ABA Standing Committee on Federal Judiciary. It consists of 11 members, one from each of the Federal circuits.

The primary sources of the Committee's information on a prospective nominee's qualifications are the opinions of the judges and the lawyers of the community involved. We endeavor to secure the views of a fair cross-section of the Bench and Bar there, always including ABA, State, and local bar association officials, and Fellows of this College. In a very real sense, our Committee is the conduit through which the informed opinion of the Bench and the Bar in a given area, sifted and weighed, is objectively conveyed to the President, through the Attorney General.

To us as lawyers it seems clear that the opinions of lawyers, through the Organized Bar, should be sought and should carry weight with the President in the appointment of judges. Government seeking a scientist for highly-skilled work in a critical scientific area would be expected to solicit the advice of the professional community of scientists. In the process of judicial appointments, government is seeking a lawyer for highly-skilled work in the critical areas of litigation and justice; it would seem equally appropriate that it officially solicit the recommendation of the professional community of lawyers.

Yet, in spite of the reasonableness of this view, vigorous protests have been voiced against the role the ABA's Standing Committee plays. Though now greatly reduced in number and intensity, these protests still continue. They come not only from disappointed candidates and their sponsors. Some officials, both in the legislative and the executive branches of Government, some newspaper editors as well, seem sincerely to believe that the influence the Organized Bar has had on judicial appointments in recent years is fundamentally wrong. We have succeeded in converting many of them as our work has progressed, and our objectives and procedures have become known and better understood. Important Senators of

both parties, in public addresses and on the floor of the Senate, have acclaimed the Committee's work; leading newspaper editors have commended the President and the Attorney General for thus seeking the views of the profession through the Organized Bar and have urged that the present system be continued and carried forward.

But the remaining critics must not be disregarded merely because they are so much in the minority. The Organized Bar is a professional agency especially qualified by experience and training, to occupy a respected position of advising on judicial selection. If we are to continue to deserve the confidence of the responsible officials in government, who call upon this Committee for advice, information, and service, and have publicly commended our efforts, we must meet and answer the arguments of the dissenters.

By continuous and public representation of our point of view, we must persuade them that only qualified lawyers should be named to judgeships in our Courts, and that the Organized Bar is the best professional agency to pronounce on the qualifications of any lawyer for the Bench. In the last analysis, citizens at large care deeply about the quality of their judges. If their concern is properly marshalled, if the facts are given them, they will heartily support and esteem every effort of the lawyers of their communities to secure the best man for each judicial post.

Above all, in carrying on our work, we must realize the extremely delicate position the Committee occupies. The Committee is not an agency of government. It has no official status. Its position and its influence can be maintained only so long as the government officials with whom it works continue to have confidence in the complete objectivity, the scrupulous fairness, and the painstaking thoroughness of the Committee's investigations and reports.

From the beginning, a problem with which the Committee has constantly grappled is the definition of "qualified." Some standards must be applied in determining whether an individual is "qualified" to be a Federal judge. But the Committee's work is collecting the opinions of the profession—of lawyers and judges—and these opinions come to us in all varieties of expression, a whole range of information and reflections. We dare not impose standards in advance of our canvass; we must, however, apply objective standards in collating all the data and the opinions we receive.

Everyone would readily agree that every person appointed to a Federal judgeship should be possessed of character, judgment, industry, experience, judicial temperament, professional ability. This is axiomatic. But to apply this principle to any given case is sometimes difficult. Long ago, a great practicing lawyer, Alexander Ham-

ilton, observing how difficult it would be in the new government to secure able judges, commented on the difficulty of accurately appraising in advance whether an individual would be a good judge. "Science," he observed, "had discovered no way of measuring the faculties of the mind." It hasn't even yet.

All of us as lawyers have observed the metamorphosis which that thin, black robe can cause in a man. But dare we count on it? The office can make, has made, its holder, on occasion. On more occasions, however, the holder has reduced the office to his own level. Normally, we can rely on a lawyer's past record as a reliable guide to his future performance. We have little else to rely on; it is his past record which our canvass of professional opinion reveals.

Sometimes, as I have said, the record reveals facts which oblige the Committee to report adversely on a prospective nominee. There is no more difficult or unpleasant task for any group of lawyers, than to report to executive authority, that an individual is deemed by his professional colleagues "Not Qualified" for a post to which he has probably aspired during the whole of his career. Unfortunately, our Committee has had to make many such unfavorable reports—as many as 27 in a single year. I assure you, we have never made an unfavorable report that was not based on especially intensive investigation, particular thoroughness, the most careful scrutiny and weighing of testimony, and a very deep searching of our own collective soul.

Many reasons may contribute to the judgment "Not Qualified." Two in particular have caused a great deal of controversy before we were able to establish them as accepted principles, at least in so far as the President, the Attorney General, and the Deputy Attorney General were concerned.

One is the matter of age. It is only three years since it has become firmly established that no lawyer 60 years or over, should be appointed to a lifetime judgeship for the first time, unless he is regarded by professional opinion as "Well Qualified" or "Exceptionally Well Qualified," and is in excellent health. This rule has not been applied to a Federal judge under consideration for elevation to an appellate court, but the rule has been that in no event, should anyone, even a judge being elevated to an appellate court, be appointed if he has passed his sixty-fourth birthday. Congress itself has decreed that a Federal Judge, with the requisite years of service, may retire at age 65 with full pay for life. Surely this is not the age at which a person should be tendered a new appointment.

One other qualification—really disqualification—has aroused even more dispute. This is the question whether a lawyer should

be required to have trial experience before he is considered qualified for appointment to the Federal Bench. In England, of course, no one but a barrister is eligible for appointment to the Bench. Our Committee has not adopted the rigid view that only trial lawyers should be considered, but we have taken the position, from which we have refused to recede, that in the case of a vacancy in a United States District Court—a trial Bench called upon to conduct the most complex and varied litigation—a lawyer to be considered must have a reasonable amount of trial experience, preferably at least some of it in the Federal courts. We have stood firm in this position, even though it has resulted in delaying appointment of needed judges for a year and a half in two cases and for more than a year in a third. In two of the cases, the individuals were incumbent United States Attorneys. Nevertheless, the President and the Attorney General supported the Committee's position and the appointments were not made.

A measure of the usefulness of the Committee to public authority may be found in the increased use of the Committee in the past few years. For example, during the first years of the Eisenhower Administration, the Committee was not consulted respecting appointments to the Supreme Court of the United States. But a change came beginning with the nomination of Mr. Justice Brennan, when President Eisenhower announced that he wished to have the report and recommendation of the ABA Committee before considering the nomination. And from that time on, by virtue of the President's decision, the Committee's role respecting Supreme Court nominations has been the same as for all other courts.

A serious complaint, proved by our experience over several years' appointments, was that the Committee's views were being sought too late in the nominating process. Usually, we received only a single name per vacancy—the person who had virtually been decided upon for the vacancy, most often with the knowledge of the prospective nominee and his Senatorial sponsor. Under these circumstances, only clearest evidence of the most glaring lack of qualification could stop the nomination.

Three years ago, in a step of the utmost importance, Judge Walsh agreed to use the Committee at a much earlier point in the selective process—to request of us an *informal* investigation and report on every individual whose name was submitted to the President or the Attorney General by any responsible source, and who therefore was likely to be seriously considered for the nomination. This preliminary screening, conducted by the Chairman and the member of the Committee from the particular Circuit in which the

vacancy exists, has provided the Attorney General with information concerning the comparative qualifications, early in the appointive process, of all probable candidates. It has in numerous cases enabled the President to hold out for the better or the best of a number of qualified candidates.

The informal requests did not eliminate formal reports. In every case, the Committee is still asked, at the same time as the F.B.I., for a formal report on the qualifications of the person who finally appears most likely to be nominated.

To accommodate the procedures of the Committee to this significant new function, the Committee no longer uses only the word "Qualified" in affirmative reports. It now distinguishes among those whom professional opinion deems "Qualified," "Well Qualified," or "Exceptionally Well Qualified."

These changes have brought singularly beneficial results, even though the informal reports have vastly increased the Committee's responsibilities and the volume of its work. In a single year, the Committee has been called upon to investigate and report on the qualifications of 127 judges and lawyers, as many as 19 in connection with a single vacancy. If they were evenly spaced, that would mean a report every two and a half working days, if the Committee worked six days a week. This gives some indication of the high level of the liaison which had developed between the Department of Justice and the Committee. It could not have been improved upon.

Most of the Committee's contacts were with the Deputy Attorney General, to whom was delegated prime responsibility for processing judicial appointments. In addressing the House of Delegates of the American Bar Association in 1959, Judge Walsh speaking of the ABA Judiciary Committee, stated: "Your chairman . . . has become, next to the Attorney General himself, I think, my most intimate associate in Washington. I work with him and spend more time with him and talk longer with him than anybody else in the Department."

By the end of the Eisenhower Administration—eight years after the Attorney General's arrangement with the ABA Committee had first been put into effect—certain statements of the utmost significance could be made with complete assurance. It could be said that no person would be considered by the President for nomination to a lifetime judgeship without first, a preliminary screening, later, a formal report to the Attorney General, by the American Bar Association's Standing Committee on Federal Judiciary. It could be said that the President would not nominate to any Federal court, including the Supreme Court, any person whom the Committee, for valid reasons stated in detail to the Deputy Attorney General, had reported

as "Not Qualified." Indeed, during the last three years of the Administration, no nomination had been made without a prior favorable report from the Committee; during these three years, two out of every three appointees to the United States courts had been rated by the Committee, not merely as "Qualified," but as "Well Qualified" or "Exceptionally Well Qualified"—designations reserved for the best qualified among those available.

In one respect, however, the record was not improved. Appointments during the past eight years have been made, as before, primarily from members of the political party of the administration in office. Invariably, Presidents have appointed judges from the ranks of their own party. Criticism on this score goes back as far as the presidencies of John Adams and Thomas Jefferson. Judicial appointments by Democratic Presidents Cleveland, Wilson, Franklin D. Roosevelt, and Truman ranged from 92% Democratic by President Truman to 99% Democratic by President Wilson. Judicial appointments of Republican Presidents Theodore Roosevelt, Taft, Harding, Coolidge, Hoover, and Eisenhower ranged from 86% Republican by President Hoover to 98% Republican by President Harding.

The implication of this is not at all to suggest that political bias or partisanship is an issue in the courtroom. The members of this College are best qualified to attest to the fact that with remarkably few exceptions in our history, Federal judges, secure in life tenure, have left political affiliations behind them when they mounted the Bench, and have conducted the judicial function without consideration of previous party associations.

And, of course, there is nothing inherently wrong about political activity prior to a lawyer's appointment to the Bench. Lawyers traditionally are leaders in politics. One of the strongest positions the ABA Committee has taken on any question is that political activity should not bar a lawyer from appointment as a Federal judge—any more than it should be his primary qualification.

But certainly we cannot expect to have full citizen respect for law and our courts, so long as members of the public have their present cynicism about "judicial appointments and politics."

Under these circumstances, the American Bar Association has long contended for the austere objective that only the best qualified lawyers or judges available should be appointed Federal judges, without regard for political affiliation. We recognize we are a long way from achieving this objective, but we shall continue to strive for it nevertheless.

In the meantime, we seek bi-partisanship in appointments as an intermediate step. This is controversial, too. There are those who

argue that in bi-partisan appointments, politics would continue to be as much of a factor as before. I do not think so. As Judge Walsh has aptly remarked, bi-partisan appointments would "reduce the impact of partisan politics on judicial selection." It would create a wholesome atmosphere around the whole issue of judicial appointments, and would be a long step toward establishing in the public mind, "the difference between a Federal judgeship and Federal patronage."

When President Eisenhower assumed office, approximately 84% of the Federal judges had been Democrats when appointed. He announced his determination to make appointments on a bi-partisan basis as promptly as possible. Four years later, when the balance of judgeships was approaching more nearly toward equality between the two parties, Attorney General Rogers stated that it would be desirable as a matter of national policy "to prevent a gross imbalance from ever occurring again." He urged both political parties, in the public interest, to arrange "appropriate safeguards" to this end.

Last Summer, for the first time in the history of either political party, the ABA Standing Committee and an ABA Special Committee, assisted by Albert E. Jenner, Regent of this College, were successful in having included in the Republican Platform, a plank calling for Federal judges to be "appointed on the basis of highest qualifications and without limitation to a single political party." (Possibly, in an oral presentation, the ABA representative might have persuaded the Democratic Platform Committee to recede from its rejection of the ABA proposal, but an unfortunate plane cancellation resulted in our representative's arrival at Los Angeles just after the meeting of the Committee had been adjourned.)

In a letter to our Regent, John Randall, then President of the American Bar Association, Vice-President Nixon said last August: ". . . I believe it is essential . . . that the best qualified lawyers and judges available be appointed to judicial office, and . . . that the number of judges in Federal courts from each of the major political parties be approximately equal . . ."

Editorial writers throughout the country hailed these statements at the time, and urged their implementation at the earliest possible moment. Undoubtedly, the stage was set for a major step forward in the substantial reduction of political consideration in judicial appointments.

That was the situation as a new Administration took over the reins on January 20, 1961.

This year 1961 may well be regarded in the future, as the start of a new era in the history of the Federal Judiciary.

In the first place, for the first time in forty years, the judges sitting in the Federal courts throughout the nation are just about evenly divided as to their pre-appointment political party affiliation —half of them Democratic, half Republican.

In the second place, there are certain to be more appointments of Federal judges to the United States courts this year, than ever before in one year—indeed in a whole Presidential term—in the history of the Country.

The Senate has passed a Bill providing for 73 new judgeships— 10 in the Courts of Appeals, 63 in the District Courts. The House Judiciary Committee has reported a Bill which would create 71 new judgeships—2 fewer District Court judgeships than in the Senate Bill. In addition, there are now 15 vacancies in existing judgeships —6 in the Courts of Appeals, 9 in the District Courts. Three recess appointments await action. These, with the normal number of vacancies created in any year by retirement and death, mean that the new appointments to be made by President Kennedy during this year are likely to reach the completely unprecedented total of perhaps as many as 125 judges.

In his entire four-year Administration, President Hoover named only 49 judges. In a similar four-year term, President Cleveland appointed 37. In 8 years, President Wilson made only 72 appointments; in more than 12 years, President Franklin Roosevelt only 106. President Kennedy will have the opportunity to make more judicial appointments this year, than President Franklin Roosevelt had in his more than three terms of office.

In the third place, the campaign of the Organized Bar for appointment of only the most qualified lawyers and judges to the Federal Bench, without regard to political party, now has the widest public acceptance it has ever received. Within the past two months, editorials and articles by columnists have been appearing in newspapers throughout the Country in increasing numbers, spotlighting the issue and in many cases urging that the time has come for a "new look"—adopting the President's words, some have said, a "new frontier"—in the matter of appointment of judges in the United States courts. This very morning's mail brought me more than a dozen such editorials and articles.

Two weeks before the Kennedy Administration took office, President Seymour and I visited Attorney General-designate Robert Kennedy and Deputy Attorney General-designate Byron White. We received their unequivocal commitment that the Kennedy Administration would continue the policy of submitting to the ABA Committee, both for preliminary screening and for later formal report,

all names of persons under consideration for Federal judicial appointment, and of appointing only those who were pronounced clearly qualified. At the hearing on his confirmation before the Senate Judiciary Committee shortly thereafter, Attorney General Kennedy reiterated this statement.

During the past few weeks, right up to the present moment, I have received from Deputy Attorney General White, requests for informal opinions on 37 individuals under consideration for 10 vacancies in Courts of Appeals and District Courts—as many as 6 for a single vacancy. I have also received 4 requests for formal reports, involving, in each case, persons as to whom our Committee had previously rendered informal opinions.

One appointment has been made—William A. McRae, Jr., a Fellow in this College, to the United States District Court for the Southern District of Florida. Our Committee had previously reported to Judge Walsh our unanimous view that Mr. McRae was "Exceptionally Well Qualified." Mr. White had called me for confirmation of this report.

Thus, the liaison between Attorney General Kennedy and Deputy Attorney General White on the one hand, and the ABA Committee on the other, is established, in so far as the system of reference for investigations and reports is concerned. There has already been developed a relationship of frank, easy, and confidential communication.

There have been, not unnaturally, certain dislocations, which if intentional, would be disturbing. In a new Administration with new personnel, some confusion is likely to occur, and there is no reason to believe that the liaison we have been accustomed to will not continue at its eminently satisfactory level. For my own part, I believe that Attorney General Kennedy and Deputy Attorney General White are entirely sincere in their declarations that they will recommend only clearly qualified persons for appointment to the Bench. The Organized Bar has no more important duty than to give them every possible support in the attainment of this objective. Obstacles will undoubtedly be thrown in their path, which the Organized Bar can assist them in overcoming.

Finally, there is every reason to believe that the President himself is determined in this objective. Some of you will recall the statement by the then Senator Kennedy in his letter of August 30, 1960 to John D. Randall, at that time the President of the American Bar Association. Senator Kennedy, after expressing full agreement with the concept of a qualified and independent judiciary as promulgated by the ABA added these very significant words:

"I would hope that the paramount consideration in the appointment of a judge would not be his political party, but his qualifications for the office.

"Please be assured of my cooperation in the effort to achieve your objectives in this regard."

A reading of the entire letter justifies the conclusion that Mr. Kennedy weighed his words carefully, and I believe he wrote them with the purpose of fulfilling his pledge if elected President.

Political pressures are great on any President, especially at the start of a new Administration, marked by a change from one party to another. They will be great now in the area of judicial appointments, despite the parity which at last exists in so far as the prior political affiliation of judges now on the Bench is concerned. However, the very large number of appointments which President Kennedy will be making, together with the substantial support of the Organized Bar and the news media of the nation, afford him the greatest opportunity which has been available to any President, to break new and significant ground in the matter of judicial appointments. With three times as many appointments in one year as most Presidents have had in a full term of 4 years, President Kennedy has sufficient latitude to enable him to meet every proper objective of the leaders of his party, and at the same time to introduce a truly bi-partisan aspect into his judicial appointments.

I must report in frankness, that since the new Administration has taken office, there has been as yet no concrete evidence of an intention to make bi-partisan appointments, nor any reiteration of President Kennedy's pledge of last August. At a hearing before the House Judiciary Committee earlier this month, Attorney General Kennedy and I testified on the need for additional judgeships. Congressman McCulloch specifically asked the Attorney General whether the Administration would make appointments from both political parties. Attorney General Kennedy did not specifically commit himself on this question; his response was, "I think the best qualified individuals should be selected as judges."

I assure you that we are not discouraged, and certainly we shall not relax our efforts. The Administration has been in office but two months. Only one appointment has actually been made. We continue to believe that as President, Mr. Kennedy will carry out the high purpose he enunciated as candidate. If he does, the cause of the sound administration of justice and the citizens' esteem for our Courts will alike be advanced.

Our efforts, as a Standing Committee of the ABA, need the continuous active support of every segment of the Organized Bar,

and of every lawyer individually. Particularly, there is a special area in which vast improvement is needed, and I solicit your help in this. Officials of State and local Bar associations, and of important professional organizations, such as the American College of Trial Lawyers, have been of incalculable assistance to our Committee in connection with our work. However, one critically important task can be performed best, perhaps only, at the local level, rather than by our national Committee. This is the task of influencing United States Senators and local political leaders—persuading them to propose no one but qualified persons for judicial appointment.

A few Senators have lately begun the practice of submitting the names of persons they were considering to State and local Bar associations. But only a few—most have not. Several Senators have been persuaded to withhold public announcement of their choices until they have had from the Attorney General a report of the preliminary screening by our ABA Committee. A number of others have recently instituted the practice of submitting several names to the Attorney General in advance of making their final recommendation, in order to learn which, among those they were considering, were deemed best qualified by the Committee. And a few have actually communicated directly with the Committee to secure our views.

But in my opinion, State and local Bar associations, and important professional groups like this College, have not even scratched the surface of their potential influence in this area. Local units of the Organized Bar simply must do more than they have done up to now, to bring the tremendous force of their influence to bear on United States Senators and political leaders to assure the sponsorship, at the very beginning of the appointment process, of qualified individuals only. For if the first candidates publicly named by any responsible person were all individuals on whom a favorable report could be given, then the ultimate choice would necessarily be made from among a much higher-qualified group.

We have, let me say, been securing a very good quality of Federal judges, some of them unusually able and qualified. The further vigorous activity by State and local Bars which I am urging would do much to eliminate the exceptions—which, of course, are the appointments which receive the greatest notoriety.

The final check on public acts, in our democratic system, is the vigorous expression of public opinion in behalf of worthy ideals. It is essential to our free society that the American people, lay and professional alike, hold the judgeship in the highest esteem, that they regard it as the symbol of impartial, fair, and equal justice un-

der law. The selective process has had enough of political pressures and partisan enthusiasms in the past. Public opinion, determined that the best men of law in each community should be persuaded to accept the most critical and demanding posts of the law, could effectively uphold the hands of all who strive to achieve this result.

It is the lawyers' task to lead in this public campaign. To foster understanding, respect, and support of our courts, is one of the most solemn duties of the Organized Bar. It can have no greater interest than the judicial system of the Country, no more pressing activity than participation in the selection, the work, and the well-being of the Bench.

I enlist you all in this cause—the next great step that lies ahead for the Organized Bar.

Case and Statute

COMMENTS

The following is a review of noteworthy recent Massachusetts cases, statutes, and rules of court, as prepared by the editorial board.

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ATTORNEY—ACTING AS ESCROW—OBLIGATIONS. *Harris* v. *Skyline Corporation et als.,* Mass. Adv. Sh. (1961) 667, 173 N.E. 2d 644.

This case discusses at some length facts relating to an attorney's undertaking to act as an escrow under which he held the sum of $350.00 until certain work was to be done on the premises of the seller of land. The attorney represented both the mortgagee and the buyers and the nature of his undertaking was that he was to deliver the $350.00 to the seller when certain grading was completed and the seller produced a compliance certificate issued by the Veterans Administration. Apparently the certificate did issue (though because of lack of due authentication, it was not received in evidence) but the buyers contended the work had not been done. The seller demanded the money. The Plaintiff brought a Bill of Complaint by way of interpleader claiming that he was a mere stakeholder and "had no obligation in respect of the escrow under which he held the sum of $350.00 except to make that sum available in court to abide a determination" between the seller and the buyers.

The Supreme Court, however, refused to proceed under this premise, vacated a final decree discharging the Plaintiff from liability, and ordered further proceedings in order to permit the Plaintiff to satisfy himself "whether a valid compliance certificate has issued." "The important circumstance," said the court, "is that the Plaintiff's undertaking was an attorney's undertaking to another member of the Bar," and having made such an engagement, the Plaintiff "could not retreat into the position of a mere stakeholder upon notice from the [buyers] that they did not wish the check delivered."

This case, which cites no other cases, is, of course, authority only for its own peculiar facts but it should serve to remind all members of the Bar who are often called upon to act in a capacity similar to that of the Plaintiff here that such undertakings will be strictly construed by our court.

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BANKS AND BANKING—CONVERSION—CONSOLIDATION. *New England Merchants National Bank of Boston* v. *The Centenary Methodist Church et al.,* Mass. Adv. Sh. (1961) 571, 173 N.E. 2d 294.

On October 13, 1960, the New England Trust Company voted to convert from a trust company under Massachusetts law into a national banking association under federal statutes with an appro-

priate change in name. As of December 31, 1960 it consolidated with the Merchants National Bank of Boston into New England Merchants National Bank of Boston—all with the approval of the U. S. Comptroller of Currency.

This is a bill for Declaratory relief by the new bank as to whether it may properly serve as trustee u/w Clark Harwood without a new appointment by the Probate Court (Middlesex). The Will provided for charitable gifts for the "care, support, and welfare of poor and needy people" in that part of Newton called Auburndale. The defendant, Auburndale Congregational Church, opposed the petition, the Attorney General expressed doubt, and the remaining defendants stood indifferent.

In tune with time, tide and trend the S.J.C. declares:

> "No longer to be applicable the restrictions on continuing identity contained in Commonwealth-Atlantic Natl. Bank, petitioner, 249 Mass. 440, Atlantic Natl. Bank petitioner, 261 Mass. 217, and Worcester County Natl. Bank, petitioner, 263 Mass. 444. We hold that after conversion the New England National Bank of Boston was not barred by any law of this Commonwealth from acting as trustee under the will of Clark Harwood. Upon the consolidation of the two national banks, no law of this Commonwealth purported to affect, much less could affect, the right of the consolidated bank, New England Merchants National Bank of Boston, to act as such trustee."
> *Q.E.D.* A bank is a bank is a bank.

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BANKS AND BANKING—HOLDER IN DUE COURSE.

Elbar Realty, Inc. v. *City Bank and Trust Company,* Mass. Adv. Sh. (1961) 465, 173 N.E. 2d 256.

In this case, decided under the law prior to the Uniform Commercial Code, an action was brought for conversion of a U. S. Treasury bond, the defendant contending it was a holder in due course of the instrument. Following a jury verdict for the plaintiff, the Supreme Judicial Court ordered a new trial because of the improper admission, on the issue of the defendant's good faith, of testimony concerning facts not known to it at the time value was given by it for the bond. Counsel for the plaintiff argued that the evidence was properly admissible because it showed facts which the defendant would have discovered had it undertaken the duty of inquiry which the jury had apparently found was imposed upon it by facts already within its knowledge at the time. The Court held,

however, that on the issue of defendant's good faith, only what it actually knew was significant in appraising whether it was acting honestly, and that the improperly admitted testimony might seriously have affected the jury's judgment on the issue of good faith.

In reaching its decision, the Court held that there was sufficient evidence to warrant submitting to the jury the question of whether or not the bond had been taken in good faith, and that the defendant was thus not entitled to a directed verdict. The test of good faith was restated from earlier Massachusetts cases to be whether or not the defendant knew facts sufficient to put it on inquiry and purposely refrained from inquiring or from knowing other facts which would have revealed lack of title in the party from whom the bond was taken. It also quoted *Macklin* v. *Macklin*, 315 Mass. 451, 455 to the effect that " (t)he rights of a holder . . . are to be determined by the simple test of honesty and good faith, and not by a speculative issue as to his diligence or negligence."

Under the Uniform Commercial Code, the definition of a holder in due course (Section 3-302) is substantially the same as that under the NIL. One of the requirements is that the instrument be taken in good faith and "good faith" is defined in Section 1-201 (19) as meaning "honesty in fact in the conduct of transaction concerned." Presumably, and particularly in view of the language quoted above from the *Macklin* case, the same test of good faith would be applied under the Code as was formerly applied under the NIL.

One other aspect of the *Elbar* case involved the issue of burden of proof. General Laws, Chapter 107, Section 82, provided at the time that " . . . when it is shown that the title of any person who has negotiated the instrument was defective the burden is on the holder to prove that he . . . acquired the title as holder in due course." The Court held that on the basis of this section, the plaintiff had the burden of establishing a defect in the title of some party who had negotiated the bond but that if this defect were established, the defendant had the burden of proof, and not merely the burden of going forward with evidence, on the issue of whether it was a holder in due course. Section 3-307 of the Uniform Commercial Code, which deals with burden of proof, states " . . . after it is shown that a defense exists a person claiming the rights of a holder in due course has the burden of establishing that he or some person under whom he claims is in all respects a holder in due course. . . ." This section, on its face, appears to contemplate a situation in which an action is brought on the instrument itself and the Comments thereto similarly appear to speak only in terms of an action on the

instrument. It is thus questionable whether the Code section goes as far as old Chapter 107, Section 82, which apparently applied to all situations involving an instrument, including that in the *Elbar* case where an action was brought for conversion of the instrument.

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CORPORATIONS—ORGANIZATION. *St. 1961, c. 97.*

The procedure for forming a corporation under G.L. c. 156, §§ 10 and 11, has been modified by adding further information relative to compliance with corporate procedure and the final date of the corporation's fiscal year and the date of the annual meeting to the articles of organization to be sworn to by a majority of the directors.

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CORPORATIONS—RESULTING TRUST OF STOCK. *Hanrihan* v. *Hanrihan,* Mass. Adv. Sh. (1961) 805, 174 N.E. 2d 449.

Two brothers, John and Edmond, owned all of the common stock of a family corporation, three sisters and another brother owning preferred stock. The children's father had died in 1914 and their mother in 1920. Each child, under the intestacy law, inherited one-sixth of their parents' estates, which consisted essentially of the family business. The business was incorporated in 1924, John receiving 525 shares of the common stock and Edmond 475. An agreement between the two brothers was obtained through the efforts of an uncle, the lower court finding that the additional shares held by John were merely security for a $5,000 differential in past income received, which was paid by 1927, and that since that time John has held 25 shares of the stock in trust for Edmond. The brothers, with some friction, shared equally in control of and income from the business but, in 1949, the judge below found that John first insisted upon exercising rights as the majority stockholder. The present action was commenced in 1951, after efforts by Edmond to avoid litigation and to settle the issues of equality of control and income. The Supreme Judicial Court found that the lower court was not plainly wrong in finding that the agreement for stock distribution included the requirement that John held 25 shares for Edmond's benefit.

John first argued that the lower court's findings concerning the agreement violated the parol evidence rule, i.e., that an oral agreement cannot vary a final written integration of the parties' agree-

ment and understanding. At the time of the original agreement, in 1923 and 1924, the mediating uncle, who was a printer, made up galleys of his proposals, and some were in evidence; in addition the incorporation papers were in evidence. The judge below found, however, that none of these writings, alone or in combination, represented the actual agreement between John and Edmond; the court here held his finding was not wrong and therefore sustained it. There being no written agreement between the parties that purported to set out their entire agreement, parol evidence was properly admitted to determine what the complete agreement was.

John next argued that Edmond's claim was barred by the statute of limitations. If the agreement was that John was to have the additional stock as security for the $5,000 pay differential, the security transaction ended in 1927 when the differential was paid. Since John did not turn over the 25 shares to Edmond, it was argued that this was a breach of contract and the six-year prescriptive period for breach of contract actions had since run. The court admitted the plausibility of this argument but did not agree. It reviewed the evidence and concluded that a resulting trust pro tanto of the 25 shares was set up for the benefit of Edmond. The arrangement for the $5,000 payment was merely an ancillary security transaction for John's benefit and did not alter the basic nature of Edmond's beneficial interest in the 25 shares held in John's name. The statute of limitations does not run on a resulting trust until the trustee repudiates it. The action by John in 1949 in exercising majority control was found by the judge below to be the time of repudiation of the trust; the finding not being plainly wrong, the bill brought by Edmond in 1951 was well within the prescripitive period.

John also argued that Edmond's claim was barred by laches. The time between repudiation and commencement of this action was not long, was used for the purpose of attempting to settle the dispute, and the action was therefore begun with reasonable promptness. The court found that John's defense was no more affected by the death of the mediating uncle in 1933 than was Edmond's claim, since each was handicapped by the unavailability of the uncle's testimony. The court also stated that John's defense of the statute of frauds was inapplicable to a resulting trust. *Brady* v. *Brady*, 238 Mass. 302, 304, 130 N.E. 677 (1921).

This case established no new principles of law within the Commonwealth, although the fact situation, simplified in this note, was very complex. The case was a close one on its facts and on the application of at least one of the objections raised by the defendant

brother. The case's importance lies primarily, however, in again illustrating to the profession the difficulties that can arise with family and close corporations, and the need for detailed and explicit written agreements between members of these corporations.

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CRIMINAL LAW—COMPLAINT—REGISTERING BETS. *Commonwealth* v. *Murphy,* Mass. Adv. Sh. (1961) 613, 173 N.E. 2d 630.

The statute (G.L. c. 271, § 17) which makes it a criminal offense to be "found in a place . . . with apparatus, books, or any device, for registering bets" has been interpreted, in the instant case, as requiring something more than mere physical presence of the defendant in the room where the apparatus is located. There must be circumstantial evidence to show a sufficient association with the apparatus, in order to convict under the statute. A complaint which describes this crime in terms of being "found . . . with apparatus" is sufficient to state the crime.

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CRIMINAL LAW—INSANITY—HOMICIDE. *Commonwealth* v. *Harrison,* Mass. Adv. Sh. (1961) 483, 173 N.E. 2d 87.

The Supreme Judicial Court, at Page 499 of the above opinion, has stated that the trial judge correctly charged the jury as to the law applicable to the defendant's defense of insanity, when the trial judge charged as follows:

> "A man is not to be excused from responsibility, if he has capacity and reason sufficient to enable him to distinguish between right and wrong, as to the particular act he is then doing; a knowledge and consciousness that the act he is doing is wrong and criminal, and will subject him to punishment. In order to be responsible, he must have sufficient power of memory to recollect the relation in which he stands to others, and in which others stand to him; that the act he is doing is contrary to the plain dictates of justice and right, injurious to others, and a violation of the dictates of duty. . . . The rule has been stated more succinctly in these terms: One whose mental condition is such that he cannot distinguish between right and wrong is not responsible for his conduct. Neither is one who has the capacity to discriminate between right and wrong but whose mind is in such a diseased condition that his reason, con-

science and judgment are overwhelmed by the disease and renders him incapable of resisting and controlling an impulse which leads to the commission of a homicide. In such a case, the homicide would not be the act of a voluntary agent, but the involuntary act of the body, without the concurrence of the mind directing it."

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CRIMINAL LAW—PRISONERS—SENTENCES. *St. 1961, c. 74, c. 75.*

Whereas, formerly, only a prisoner who was serving a term in a correctional institution was entitled to have his sentence reduced by the number of days spent by him in confinement prior to such sentence and awaiting trial, now a prisoner serving a term in a house of correction or a jail has the same right.

Similarly, in the matter of imposition of sentence by the Court, prisoners being sentenced to a house of correction or to a jail now enjoy the same rights as prisoners being sentenced to a correctional institution, in that they shall be deemed to have served a portion of such sentence equivalent to the number of days spent in confinement prior to such sentence awaiting and during trial.

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DAMAGES—WRONGFUL DEATH—DEFECTIVE WAYS AND BRIDGES. *St. 1961, c. 166.*

The maximum recovery permitted against municipalities in actions for death resulting from a defect, want of repair or want of sufficient railing upon a way, causeway or bridge, has been increased from $1,000 to $4,000.

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EQUITY—EXONERATION—TORT LIABILITY. *Benway* v. *Porter Chevrolet, Inc.,* Mass. Adv. Sh. (1961) 765, 174 N.E. 2d 25.

The Court here refused to apply the doctrine of equitable exoneration in favor of the owner of a motor vehicle as against the operator of the vehicle and the operator's employer, no liability of anyone to the injured plaintiff in the underlying personal-injury action having been determined.

The plaintiff in this bill of complaint, the service manager of the defendant Porter, gave instructions for the repair of his own

automobile to his own repair department, for which repairs the plaintiff did not expect to be charged. The defendant Campbell, a mechanic employed by Porter, while road-testing the car, struck and injured one Leavitt, plaintiff in the underlying tort action, in which Benway, Porter and Campbell have been sued.

The Court, in holding that this was not an appropriate case for the application of the doctrine of equitable exoneration, pointed out that Leavitt has not established liability on the part of anyone, nor is there any certainty that liability will be established hereafter, and therefore the elementary requirement of exoneration is missing.

Furthermore, if Leavitt were to establish liability against Benway, it cannot presently be determined whether that liability would be based solely on the "prima-facie agency" statute, G.L., c. 231, § 85A, as Benway in effect contends, or upon other evidence. Leavitt's tort action is not to be hampered by collateral judicial forecasts as to the outcome.

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EVIDENCE—INFERENCE—BURDEN OF PROOF. *Hillery* v. *Hillery*, Mass. Adv. Sh. (1961) 585, 173 N.E. 2d 269.

Here we find an excellent example of the rule that evasiveness or untruthfulness on the part of a party litigant cannot itself be the basis of a finding of fact, where the burden of proving that fact lay upon the opposite party. Conduct of that sort by a party may be treated as in the nature of an admission, but it cannot totally take the place of affirmative evidence. Such an implied admission may turn the scale where the evidence is conflicting, but it forms an insufficient foundation for the erection of an entire case by mere inference without other evidence. Specifically, the libelee in this case was, in the opinion of the trial judge, evasive and misleading in his testimony as to his financial income. In the absence of other affirmative evidence concerning his income, however, this unsatisfactory evidence was insufficient foundation from which the Court could infer that the libelee's income was substantially greater than the amount claimed by him in his testimony.

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INSURANCE—MOTOR VEHICLE—ARBITRATION. *St. 1961, c. 92.*

The provision for arbitration of disputes between the assured and insurer for losses under a property-damage collision coverage policy, first enacted by St. 1960, c. 793, has been rewritten.

Apparently now arbitration is not a condition precedent to a right of action to recover for such loss, nor in the award of the arbitrators expressly made final and conclusive upon the assured or the insurer. Furthermore, there need not be arbitration unless either party demands it. The revised statute has also changed somewhat the mechanics of the arbitration proceeding and specifies the manner in which the cost of it is to be borne.

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JURISDICTION—SERVICE OF PROCESS—NON-RESIDENT MOTORIST. *Nickerson* v. *Fales,* Mass. Adv. Sh. (1961) 389, 172 N.E. 2d 832.

This decision points out the necessity of strict compliance with the provisions of G.L. (Ter. Ed.) c. 90, §§ 3A-3C, if jurisdiction is to be acquired over a non-resident motorist through service of process on the Registrar of Motor Vehicles. Here, the plaintiff brought suit against the Rhode Island defendants, owner and operator, service of the writ being made upon the Registrar, but the plaintiff failed to give the defendants notice of the service and to forward copies of the writ to the defendants. Almost two years later, when the defendants appeared specially and moved to dismiss the action, the plaintiff attempted to cure the defective service by requesting and obtaining orders of notice, which he then served upon the Registrar, forwarding copies to the defendants.

The substituted service statute requires notice forthwith to the defendants, together with a copy of the process, admittedly not accomplished by notice nearly two years after commencement of the suit.

The Court held that G.L. c. 90 § 3C, provides the exclusive procedure for notice of substituted service, and hence the "forthwith" requirement must be strictly observed. In this instance, G.L., c. 223, § 84, permitting curing of defective service by issuance of orders of notice does not apply and cannot be used to cure a defect in service under §§ 3A-3C.

Clearly, the issue here is the constitutional concept of due process of law, a basic requirement of which is notice to a defendant over whom jurisdiction is sought to be acquired in this substituted manner. The fundamental rights of a defendant are to be zealously protected even though the effect, as here, is that the plaintiff finds himself out of Court.

JURY TRIAL—SIX-MEMBER JURY—WORCESTER COUNTY. *St. 1961, c. 89.*

The practice of trying civil actions to a jury of six members in the Central District Court of Worcester has again been extended so as to include actions entered up to or on July 1, 1964.

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LANDLORD AND TENANT—PERSONAL INJURIES—COMMENCEMENT OF TENANCY—TERMINATION OF TENANCY. *Bridges et als.* v. *Boston Housing Authority, Mass.* Adv. Sh. (1961) 403, 172 N.E. 2d 838; *Goode et als.* v. *Esterman,* Mass. Adv. Sh. (1961) 769, 174 N.E. 2d 29.

Since one in control of demised premises owes to the tenant, or one claiming under the tenant, the obligation of exercising reasonable care to keep the premises in the condition in which they were or appeared to be at the time of the letting, one of the material issues in any such case will be the determination of the exact time of the letting. The above two cases construe unusual circumstances, concerning this issue.

In the *Bridges* case, above, it appeared that the parents of the minor plaintiff began their occupancy of the defendant's premises in 1953 or 1954. It also appeared that a lease was signed on June 1, 1957. The Supreme Judicial Court held that there should be a new trial. If an entirely new tenancy began on June 1, 1957, the plaintiff could not, on the record, recover, because of the lack of evidence of the condition, care and maintenance of the premises at that time. On the other hand, if it was held that the controlling date was 1953 or 1954, the evidence would be sufficient to warrant a finding for the plaintiff on that issue. The Court ordered the new trial upon the ground that the facts on which the rights of the parties depend have not been ascertained at the trial, and that it is within the power of the Supreme Judicial Court, in its discretion and of its own motion, to recommit the case for retrial. The mere fact that a written lease was executed in 1957 was not significant, since minor alterations in the contractual relationships of the parties would not be sufficient to create a new letting in such a case, and for all that the record showed, there may have been little or no change brought about by the 1957 lease. It seems significant to note that the Court awarded a new trial in a case wherein the facts relating to a ma-

terial issue had been left in a state of conjecture, and the burden of proving those facts rested upon the plaintiff.

In the *Goode* case, above, the plaintiff became a tenant at will of the defendant in 1954. On May 22, 1958, in a summary process proceeding, there was a finding for the plaintiff (the defendant in this case) for possession. However, execution was stayed until September 1, 1958. On July 7, 1958, the plaintiff was injured, and brought action for personal injuries against the landlord. The Court held that the tenancy at will, begun in 1954, was terminated on April 30, 1958, the end of the notice period in the summary process proceeding. The summary process proceedings made it res judicata that the tenancy was ended. That date, April 30, 1958, became the controlling date in determining the issue as to whether there had been a deterioration in the common area.

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MOTOR VEHICLES—OPERATING UNDER THE INFLUENCE—EVIDENCE OF INTOXICATION. *St. 1961, c. 340.*

Evidence of the results of chemical analysis of a defendant's breath or blood for alcoholic content is made admissible in prosecutions under G.L., c. 90, § 24, provided that, if the analysis is made by or at the direction of a police officer, the defendant consents to the making of the analysis and is afforded a reasonable opportunity to have another test made by someone of his selection. However, evidence that the defendant refused to consent to the analysis shall not be admissible in any criminal or civil proceeding against him. The statute sets forth presumptions of intoxication and non-intoxication, according to certain specified percentages of alcoholic content.

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MOTOR VEHICLES—OPERATING UNDER THE INFLUENCE—WAYS. *St. 1961, c. 347.*

Those places upon which operation of a motor vehicle while under the influence of intoxicating liquor is subject to prosecution have been expanded to include not only ways and places to which the public has a right of access, but also any way or in any place to which the public has access as invitees or licensees, such as privately-owned parking lots and the like.

MOTOR VEHICLES—PARKING VIOLATIONS—TOWING BY CITIES AND TOWNS. *St. 1961, c. 322.*

Cities and towns are authorized, by accepting this chapter, to set up machinery for the towing of illegally parked vehicles from city or town ways. A maximum towing fee of $8.00 and a maximum storage fee of $1.50 per 24-hour period, and $1.00 for a lesser period, have been established. A further provision of note is that acceptance of the chapter may be revoked at any time after the expiration of one year from the date of acceptance.

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MOTOR VEHICLES—RAILROAD CROSSINGS—STOPPING. *St. 1961, c. 248.*

The provisions of G.L., c. 90, § 15, requiring stopping within seventy-five feet of a railroad crossing at grade under certain circumstances have been expanded to include all motor vehicles when the crossing is protected by flashing red lights or by an automatic gate, requiring stopping within that distance while such lights or flashing or such gate is lowered.

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MOTOR VEHICLES—SALE—NOTICE. *St. 1961, c. 45.*

It is no longer necessary for an individual desiring to sell his motor vehicle to file a four-day notice of intent to sell with the Registrar of Motor Vehicles and with the Chief of Police or Selectmen in the town in which the sale is to be made. There is now no notice requirement. This repeals G.L., c. 140, § 65.

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MUNICIPAL GOVERNMENT—BUILDING BY-LAWS—BOARD OF APPEALS—EQUITY JURISDICTION OF APPEAL. *Rice et al.* v. *Board of Appeals of Dennis,* Mass. Adv. Sh. (1961) 737, 174 N.E. 2d 355.

The Dennis Board of Appeals purported to grant a variance to one Lane from the town building code to permit a reduction of the set-back line from twenty-five to seven feet. Prior to the decision of the board, Lane had made no application for a building permit, nor had the building inspector refused to issue a permit. The variance was granted on an application to the board by Lane in letter form. After the granting of the variance, the building inspector

issued a building permit. The plaintiffs, owners of property across the street from Lane, appealed by means of a bill in equity under G.L., c. 40A, § 21.

In dismissing the bill, the Court held:

(1) Although it had authority to consider an appeal from a person aggrieved by the issuance of a building permit or by the refusal of the building inspector to issue a permit, the board of appeals had no authority under the building code to act as an administrative body of original jurisdiction.

(2) The plaintiffs could not properly bring an appeal under G.L., c. 40A, § 21, because that statute applies only to zoning appeals.

(3) The issuance of a building permit was not "an order, requirement or direction" of the building inspector from which the plaintiffs could appeal to the Superior Court under G.L., c. 143 relating to the building code.

(4) Two years having elapsed, the plaintiffs could not have proceeded by certiorari.

(5) The board of appeals lacked jurisdiction to grant the variance and the Superior Court had no jurisdiction of the appeal.

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MUNICIPAL GOVERNMENT—PUBLIC CONTRACTS—APPROVAL OF CONTRACT BY MAYOR. *Singarella et al.* v. *City of Boston,* Mass. Adv. Sh. (1961) 601, 173 N.E. 2d 290.

The pertinent statute (St. 1890, c. 418, § 6, as amended by St. 1950, c. 216, § 1) requires that every contract made by a department of the city of Boston involving a thousand dollars or more must be in writing, and "no such contract shall be deemed to have been made or executed until the approval of the mayor of said city has been affixed thereto in writing."

In this case, the trustees of the hospital department voted to award the contract to the plaintiffs. The hospital department sent the contract forms to the mayor with a letter stating the plaintiffs were the lowest bidders. The mayor, having full and complete understanding of the contract, signed his approval on the bottom of the letter. The letter was at all times stapled to the contract forms. The trustees and the plaintiffs then signed the contract and the

plaintiffs started work. Thereafter, the city informed the plaintiffs it would not go through with the contract.

The Court held the mayor's approval of the contract prior to its execution was a sufficient compliance with the statutory requirement. The plaintiffs' exception to the direction of a verdict for the city after the opening statement by the plaintiffs' counsel was sustained.

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PRACTICE AND PROCEDURE—AUDITOR'S REPORT—MOTION TO STRIKE. *Shine* v. *Campanella & Cardi & Sons Construction Company et als.,* Mass. Adv. Sh. (1961) 337, 172 N.E. 2d 693.

This case holds that G.L. c. 221, § 56, is not to be interpreted to preclude a judge before trial from acting upon a motion to strike part of the auditor's report, in a case where the auditor's report is not facts final. The language of the statute provides that "the Court at the trial shall exclude any finding of fact which appears in the report to be based upon an erroneous opinion of law, or upon inadmissible evidence," but the Court holds that this is a provision as to what the trial judge is to do in the nature of a ruling on evidence. Orderly procedure often requires that a determination of the extent to which an auditor's report may be received in evidence should be made before the day of trial and even before final preparation for trial in the summoning of witnesses. Such procedure, well before trial commences, will enable a seasonable recommittal to the auditor in an appropriate case. It seems even more clear that, where a motion to recommit has been filed by the aggrieved party, as opposed to a motion to strike as filed in the instant case, opportunity for consideration by the Court should be afforded considerably before the case is called for jury trial.

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PRACTICE AND PROCEDURE—DISTRICT COURTS—RETURN DAYS. *St. 1961, c. 375.*

Beginning on January first, 1962, the return day for writs, processes, notices to appear and citations in all civil proceedings in district courts will be Monday of each week, unless Monday is a legal holiday, in which case the return day will be the next business day. Clerks will still be required to accept such writs and processes at any time within three days prior to the return day.

PRACTICE AND PROCEDURE—ENTRY OF JUDGMENT—REVIEW OF JUDGMENT. *Reubens* v. *Boston Federal Savings and Loan Association,* Mass. Adv. Sh. (1961) 719, 174 N.E. 2d 352.

In this case a judge of the Superior Court allowed a plaintiff's petition for a writ of review, although the petition was filed more than one year after judgment was entered for the defendants in the original action. The Supreme Judicial Court sustained the exceptions, and in doing so clarified two procedural questions. First of all, the opinion states that the judgment in the original action was rightly entered for the defendants, because the plaintiff, after a demurrer had been sustained and the plaintiff had been granted leave to amend within a specified time, had neglected to obtain allowance of his motion to amend his declaration. Since the plaintiff merely filed a paper entitled, "Plaintiff's Amended Declaration," and did nothing further within the specified time for amendment, judgment properly entered after the time expired.

In discussing the issue of the one-year limitation connected with the writ of review, the opinion states that a petition for a review may properly be allowed, after one year, only in those cases where the original judgment was rendered in the "absence" of the petitioner and without his knowledge. Absence, in this context, is deemed to be related to service of process, rather than physical presence of the petitioner within the jurisdiction. If the petitioner was duly served with process in the original action, he is not thereafter absent for these purposes. In the instant case, since the petitioner was originally a party plaintiff, and had initiated the litigation, the Court holds that he can never be absent within the meaning of this one-year limitation.

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PRACTICE AND PROCEDURE—NEW TRIAL—JURY-WAIVED CASE. *Mealey et als* v. *Super Curline Hair Wave Corporation,* Mass. Adv. Sh. (1961) 507, 173 N.E. 2d 84; *Webber* v. *Johnson et als,* Mass. Adv. Sh. (1961) 679, 174 N.E. 2d 40.

These two cases are noteworthy in that they emphasize most of the procedural rules controlling in those instances where a party has filed a motion for a new trial after a trial without jury. Some of these rules are: (1) a new trial after jury verdict may be granted for any cause for which it could be granted at common law but only for the reasons stated in the motion (G. L. c. 231, § 127, 128), but

where the trial is jury-waived a new trial may be ordered without the statement of reasons, for in such cases the statutes do not apply, (2) nor do the statutes apply where the judge sets aside a verdict which he has ordered, since no questions or issues were submitted to a jury, and the judge is in effect setting aside his own motion, (3) the trial judge, after jury-waived trial, can properly grant a new trial if he believes it to be in the interest of justice, and it is unnecessary to pass upon the validity of any reasons advanced by him, (4) in a case tried without jury a party may not, as of right, be heard on a motion for new trial except on the grounds of "mistake of law" and "newly discovered evidence."

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PRACTICE AND PROCEDURE—VACATING JUDGMENT.

Fox v. *Bottomly,* Mass. Adv. Sh. (1961) 141, 172 N.E. 2d 255; *Anderson* v. *Goodman,* Mass. Adv. Sh. (1961) 145, 172 N.E. 2d 257; *Medford Red Cab, Inc.* v. *Duncan et al,* Mass. Adv. Sh. (1961) 149, 172 N.E. 2d 260; *Mede* v. *Colbert,* Mass. Adv. Sh. (1961) 357, 172 N.E. 2d 700.

In four recent decisions the Supreme Judicial Court has considered the plight of the litigant whose inactivity has resulted in judgment being entered against him.

The granting of a petition to vacate judgment "rests largely, although not exclusively, in the sound discretion of the Court." Clearly, the petitioner has the fundamental burden of showing that he has a meritorious claim or defense worthy of a trial in Court. However, in certain instances, factors other than the merit of the claim or defense, when involved, may well prove to be ultimately determinative of the final outcome.

Anderson v. *Goodman,* Mass. Adv. Sh. (1961) 145, involved a petition to vacate a judgment entered by default in an action of contract in the Municipal Court of the City of Boston. The petition was denied in the Municipal Court but, upon appeal to the Superior Court, was allowed after hearing. The respondent's exceptions were overruled, the Court indicating that the trial judge need look no further to find evidence that the petitioner had a meritorious defense than to the respondent's answer, which indicated the pendency of a suit in equity brought by this petitioner and involving the same matter, wherein the Equity Court took jurisdiction and suspended sale of the real estate attached in this law action until the bill in equity is decided in the Court. On the matter of lack of diligence, the evidence was that the petitioner had received no notice of the marking for trial.

In *Medford Red Cab, Inc.* v. *Duncan,* Mass. Adv. Sh. (1961) 149, the trial judge's denial of the petition to vacate judgment entered by default in a tort action was overruled. The evidence at the hearing, which consisted solely of statements of counsel for the parties, indicated the existence of a meritorious defense to the plaintiff's claim, as it appeared that a conflict existed as to whether the closing of the door of the petitioner's taxicab on the respondent passenger's thumb was caused by the stopping of the taxicab on an incline or by the respondent's own action in closing the door on her thumb. Although the Court expressly refused to indicate any views which might he helpful upon the rehearing of the petition, it is interesting to note that the petition alleged that the insurer of the petitioner, the defendant in the original action, was not notified of its assured's default, in accordance with the provisions of G.L. (Ter. Ed.) c. 231, § 58A, prior to the assessment of damages and the entry of judgment.

The first of the two decisions in which the petition for vacation of judgment was denied because of matters other than the merits of the claim or defense, *Fox* v. *Bottomly,* Mass. Adv. Sh. (1961) 141, involved a petition to vacate a judgment by default in a contract action. The trial judge allowed the petition on the condition that the petitioner file a surety company bond within ten days. The petitioner excepted to the order but failed to file a bond. The Court held that, even assuming that the trial judge found that the petitioner had a meritorious defense, the petitioner had, through personal service upon him of the writ and summons in the original action, actual knowledge that the action was pending against him. He was, therefore, clearly obliged under G.L. (Ter. Ed.) c. 250, § 17, to give a bond and did not fall within the exception of G.L. (Ter. Ed.) c. 250, § 18, wherein lack of actual knowledge of the pendency of the action permits vacation of judgment without giving security. The fact that the petitioner had no actual knowledge that the writ was entered on the return day is of no consequence. Hence, failure to observe the clear requirement of filing a bond as a condition of the vacation of judgment resulted in denial of the petition.

In *Mede* v. *Colbert,* Mass. Adv. Sh. (1961) 357, the petitioner was the plaintiff in the original action of contract on a witnessed note, in which action a judgment of dismissal under Superior Court Rule 85 was entered in June, 1959. A motion to restore the case to the trial list was allowed in November, 1958, after the plaintiff had received notice that the case had been marked "inactive" under Rule 85. There was no further activity by the plaintiff until this petition, after discovering in May, 1960, that the action had been dismissed.

In overruling the trial judge's allowance of the petition, the Court stated that there was no evidence, which consisted entirely of statements of counsel, to the effect that the petitioner had a meritorious claim, which in itself required sustaining the respondent's exceptions. The Court went further, however, and ruled that the petition must be dismissed altogether as a petition to vacate judgment does not exist for excusing of conduct so lacking in diligence as that of the petitioner. It might be noted in passing that the petitioner's cause is not irredeemable, however, as the statute of limitations has not run against the petitioner and a judgment of dismissal is not res judicata in another action brought for the same cause. *Farnum* v. *Brady,* 269 Mass. 53, 168 N.E. 165.

If any general conclusion can be drawn from a synthesis of these four decisions, it might be that, while the petitioner may find some sympathy when he can show that he has a meritorious claim or defense and in other respects his inactivity does not run counter to pertinent statutes or rules of Court or other matters germane to his petition, he will find himself in a far less sympathic situation if he does not adhere strictly to the requirements of such collateral matters.

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PROBATE—WIDOW'S ALLOWANCE. *Townsend* v. *Wood,* Mass. Adv. Sh. (1961) 715, 174 N.E. 2d 420.

The Testator died with an Estate inventoried at some $250,000 in personalty and $28,500 in realty, leaving a seventy (70) year-old widow with a meager income of her own. At "an ex parte hearing at which only Counsel for the widow and the Executors were present" the Probate Court awarded a widow's allowance of $15,000, taking into consideration that the "deceased during his lifetime was living on approximately $1,500.00 per month, employing a maid and gardening services" and that there "is a necessity to keep the realty in up-to-date condition. . . ." A daughter of the Testator, as life tenant of a residuary Trust under the Will, appealed.

Held, the award is too much in that it "was either for necessaries for more than a short time or for more than necessaries which the Statute does not permit. G.L. c. 196, § 2." Case remanded to the Probate Court (Middlesex) for determination of an amount more in line with the widow's need for funds "to adjust herself to her new situation."

For a considerable time a widow's allowance was deductible for Federal Estate Tax purposes. Abuses set in, and the privilege was lost. Now the play is to qualify the award for the Marital Deduc-

tion under varying local law of each of the 50 States. To date the answer has been affirmative in five States (Mich., Ill., Nev., Iowa, Ga.) and negative in two (Calif., Ore.) and the game goes on—with the stakes in this as yet undecided Commonwealth substantially reduced by the above case.

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REAL PROPERTY—ADVERSE POSSESSION. *Kershaw et al.* v. *Zecchini et al.,* Mass. Adv. Sh. (1961) 527, 173 N.E. 2d 624.

This is a case in which our Court reiterates and somewhat refines the requirements for obtaining title by adverse possession of unimproved land. The Plaintiffs here were conceded by the Defendant to have a superior record title and the Defendant was conceded by the Plaintiffs to have performed acts from 1943 to 1958 which were sufficient to constitute adverse possession. These acts consisted of the construction of a wall, the removal of stones, and the building of a house. The only question to be decided by the Court was whether the acts of the Defendant's predecessor in title during the period 1936 to 1943 constituted conduct of such a nature that they could be tacked on to the 1943 to 1958 period to benefit the Defendant.

The facts brought out were these:

The Defendant's predecessor and his wife were "circus performers who, between periods of employment, lived with the Defendant and his wife in a house located diagonally across the road from the locus." They had cleared the locus of brush, put bound pipes at the corners, cut trees, and during the period in question; i.e., 1936 to 1943, with the Defendant they regularly exercised and practiced stunts on the lot "when they were in town."

The trial judge in finding for the Defendant "on all the evidence" reiterated the requirements for adverse possession and found that the Defendant and his predecessor exercised dominion over the locus under claim of right "openly, notoriously and continually for a period of more than twenty years." The Supreme Court affirmed the decree. The Court disposed of the Plaintiffs' claim that the acts of the Defendant were insufficient in law to constitute a disseisin by stating that although it was mindful of the strict rule reviewed in *Cowden* v. *Cutting,* 339 Mass. 164, 169, as to the requirements of disseisin in the case of wild or woodland, nonetheless "whether in a particular case these elements are sufficiently shown is essentially a question of fact. This is because the nature and extent of occupancy required to establish a right by adverse possession

vary with the character of the land, the purposes for which it is adapted, and the uses to which it has been put."

The facts that the Defendant's predecessor did not reside on the property, that he took frequent circus trips and that the Defendant participated in the acts of disseisin did not here destroy the exclusiveness of the possession exercised by the Defendant's predecessor, said the Court.

Additionally, it is interesting to observe that in this case, which was a Bill in Equity in the Land Court under General Laws, Chapter 231-A, Section 1, the trial judge made extensive findings which he designated as "material facts." The Court points out that no statutory authority exists under which a party in the Land Court can obtain as a right a report of material facts but it assumed "without deciding" that the findings here were to be treated as if they were statutory "material facts." See General Laws, Chapter 214, Section 23, and General Laws, Chapter 215, Section 11.

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REAL PROPERTY—DISCRIMINATION—SALE.
St. 1961, c. 128.

The anti-discrimination statute relating to publicly assisted or multiple dwelling or contiguously located housing has been extended beyond rental and leasing of such housing and now includes discrimination in selling or negotiating to sell such housing. It also includes licensed real estate brokers in the group toward which the statutory prohibitions are directed.

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REAL PROPERTY—LITTORAL PROPERTY—ACCRETIONS.
Michaelson et als. v. *Silver Beach Improvement Association, Inc.*, Mass. Adv. Sh. (1961) 453, 173 N.E. 2d 273.

The plaintiffs, owners of property fronting on Wild Harbor in Falmouth, brought a bill in equity against an association of residents of Silver Beach, asking that the association and its members be enjoined from using the beach immediately in front of the plaintiff's land for usual beach purposes.

Prior to 1950, the water even at low tide had come up to the plaintiff's sea wall. In 1950, the Commonwealth, by dredging and pumping sand from the floor of the harbor, caused enough sand to be cast against the sea wall so that a beach was created between the sea wall and the harbor. It was the status of this newly created beach which was in issue.

If the plaintiffs owned to the new low-water mark, they were entitled to the injunction they sought, their ownership being subject only to the public rights of navigation, fishing and fowling, and to a possible public taking. If ownership of the new beach was in the Commonwealth, then the general public, including the membership of the defendant association, was entitled to use it for normal beach purposes.

Where the littoral proprietor, as in this case, owns to the low-water mark, his boundary line is subject to change by accretions. Such accretions need not be due entirely to natural causes, provided they are not caused by the littoral owner himself. These plaintiffs contended that the land created by the Commonwealth belonged to them as littoral owners, as would a gradual growth of beach by natural accretions, or by natural accretions aided by an artificial force.

The defendant contended that, the beach having been created solely by the Commonwealth, the principles governing accretions did not apply. That was the result in *Home for Aged Women* v. *Commonwealth,* 202 Mass. 422, a case involving the filling in of a strip of land outside the plaintiff's sea wall along the Charles River.

The Court distinguished this latter case, however, noting that "in the interest of safer and more convenient navigation over the flats along the Charles River, and of the public health and comfort, the construction of the dam and the filling of a strip of land outside of the sea wall were treated by the Legislature as parts of a single project for the public good." In the instant case, on the other hand, the Court found no substantial and reasonable connection between the dredging of Wild Harbor, a project to improve navigation, and the creation of the new beach. It was held, therefore, that *Home for Aged Women* v. *Commonwealth* did not control and that the principles governing accretions applied. The plaintiffs were held to be the owners to the new low-water mark and to be entitled to an injunction.

The defendant contended, as to two of the plaintiffs, that the description of their lots in their Land Court transfer certificates of title showed their land bounded "by Wild Harbor," that these words were ambiguous and the defendant was therefore entitled to show by the underlying deeds that these two plaintiffs in fact owned only to the high-water mark. The Court held that the words "by Wild Harbor" were unambiguous and indicated a boundary at low-water mark. This being so, the plaintiffs were entitled to rely upon the description in their transfer certificates of title.

REAL PROPERTY—RESULTING TRUST—EVIDENCE TO PROVE WRITTEN INSTRUMENT. *Bellamy* v. *Bellamy,* Mass. Adv. Sh. (1961) 777, 174 N.E. 2d 358.

In 1945 Josephine, a widow, purchased a home in her own name. On the same day she conveyed the property to herself and her son, Alessio, as tenants in common, with the verbally expressed understanding between Alessio and herself that after her death the title would be put in the names of all eleven of her children. In 1948, repairs and alterations were needed on the home. Alessio was in Tennessee on navy duty and, to facilitate procurement of funds, Josephine and Alessio conveyed the property to a son, Anthony, and a daughter, Laura, as tenants in common. At the time of this transfer Josephine wrote Alessio telling him that she was conveying the property to Anthony and Laura under the same limitation, that the property was to be equally owned by all the children at her death, and that they had agreed. Alessio returned the signed deed, with a letter to his sister, Laura, and brother, Anthony, stating that this equal ownership understanding was still applicable to the property. Evidence was admitted indicating that Anthony and Laura had not only seen their mother's and Alessio's letters but had also expressly agreed to the conditions. The two letters were not introduced in evidence, Josephine's letter apparently having been destroyed by a flood and Alessio's letter not being found after extensive search; those children who had seen or written the letters testified as to their content.

Josephine managed the property until her death in 1953. In 1955, just prior to her marriage, Laura conveyed her interest in the premises to Anthony, who thus became sole owner in fee. Anthony married in 1958 and died in early 1959; his widow claimed sole ownership of the property. The ten surviving children of Josephine brought suit in equity seeking a conveyance of the property to them and the defendant widow, each to have a one-eleventh interest as tenant in common. The judge granted the relief sought and the Supreme Judicial Court found no error.

The first evidentiary objection of the defendant was to the admission of testimony by Alessio of oral statements made to him by Josephine and of the letter she sent him. The Court summarily rejected this objection under G.L. c. 233, § 65, governing the admissibility of declarations of decedents in civil actions.

Somewhat more complex was the defendant's argument that, to show a resulting trust in this real estate, a writing evidencing the trust must be proven. G.L. c. 203, § 1, states: "No trust concerning

land, except such as may arise or result by implication of law, shall be created or declared unless by a written instrument signed by the party creating or declaring the trust or by his attorney." In addition, G.L. c. 259, § 1, Fourth, the Statute of Frauds, states that no action can be brought upon a land contract not in writing. The short answer of the Court to this argument was that the issue was not whether parol evidence was admitted for the purpose of proving the trust but whether parol evidence could be admitted as secondary evidence of a writing to prove a trust.

Under the Best Evidence Rule, a written instrument must be proven by the instrument itself if it is available. If it is not available and if the proponent of the instrument is not culpable in its loss or disappearance, all jurisdictions permit the proponent to prove the instrument by secondary evidence. Most jurisdictions have a hierarchy of secondary evidence, in which various types of such evidence are preferred over others. Thus, in proving a written instrument, these jurisdictions generally require that, before oral evidence of the instrument can be introduced, all other types of secondary evidence must be shown to be unavailable, upon the same standards as are applicable to the instrument itself. Massachusetts does not, however, have any preferred secondary evidence and thus, once it was shown in this case that the letters themselves were unavailable for reasons that were not the fault of the proponents of the letters, oral evidence could be directly introduced to prove their existence and content.

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STATE GOVERNMENT—CLAIMS AGAINST COMMONWEALTH—CONSENT TO SUIT. *Executive Air Service, Inc.* v. *Division of Fisheries & Game et als. (and a companion case),* Mass. Adv. Sh. (1961) 567, 173 N.E. 2d 614.

These are two companion cases, the first a petition for declaratory relief under General Laws, Chapter 231-A, and the second petition under General Laws, Chapter 258, which concern claims against the Commonwealth. The allegations in each case were substantially the same; demurrers were filed in each case and, in each, the demurrers were sustained.

The Plaintiff, for many years, had operated the Coonamesset and Falmouth Airports in Falmouth on about eighty acres of land leased to it by the Coonamesset Ranch Co. The land covered by the Plaintiff's lease was part of a two-parcel tract containing some 1,400

acres purchased by the Division of Fisheries & Game under General Laws, Chapter 131, Section 25, as amended, and the Commonwealth was the grantee in the deeds which are the subject of the Plantiff's lease. Approval of the Selectmen of Falmouth was not obtained in accord with the provisions of Chapter 131, Section 25. The Division of Fisheries ordered the Plaintiff to terminate activities at the airport. The first case, brought under General Laws, Chapter 231-A, named the Division of Fisheries & Game, the Commonwealth and the Coonamesset Ranch Co. as Defendants; the second case brought under Chapter 258 named the Division of Fisheries & Game and the Commonwealth as Defendants. Under Chapter 231-A, the Plaintiff, among other things, sought a binding declaration of the validity of the deeds to the Commonwealth and, under Chapter 258, the prayers were for injunctive relief and damages.

In each case, in affirming the orders sustaining the demurrers, the Supreme Court stated that the Commonwealth was the real party in interest and, therefore, the cases could not proceed against it for neither in Chapter 231-A nor in Chapter 258 had the Commonwealth tacitly or impliedly consented to become a party Defendant in this type of suit. The court distinguished these cases from cases such as *St. Luke's Hospital* v. *Labor Relations Commn.,* 320 Mass. 467, where "the agency was the only party directly concerned."

With respect to the case brought under Chapter 231-A, the Court points out that the decision reached here is consistent with those reached in other jurisdictions.

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TAXATION—INSURANCE COMPANY—FOREIGN COMMERCE. *Springfield Insurance Company* v. *State Tax Commission,* Mass. Adv. Sh. (1961) 745, 174 N.E. 2d 455.

Premiums received by a domestic insurance company covering risks in foreign countries must be included in the company's premium excise tax under G.L. Ch. 63 § 22. The Supreme Judicial Court rejected the contention that an assessment based upon premiums for business within foreign countries imposes an undue burden on foreign or interstate commerce. The Court held that the tax was an excise upon the value of the company's franchise which could be imposed by the state of incorporation without violating the due process clause of the Fourteenth Amendment to the Federal Constitution.

TAXATION—MUNICIPAL TAXATION—DEFICIENCY AFTER FORECLOSURE. *City of Boston* v. *Gordon* (and companion case, *City of Boston* v. *Woodward Apartments, Inc.)*, Mass. Adv. Sh. (1961) 835,   N.E. 2d.

In these two actions the city of Boston sought to recover the balance due on real estate taxes after foreclosure of the tax title on the premises. The real estate involved was an apartment building owned by Gordon until December 31, 1952 and by the apartment corporation until February 4, 1958. The taxes for 1948 through 1958 were not paid. In 1950 the Boston collector took the locus for non-payment of the 1948 taxes and the taxes for 1949 through 1956 were added upon certification to the tax title account of the locus. On February 4, 1958, the Land Court foreclosed the tax title. The present actions were brought on October 17, 1958.

These facts raised a number of complicated problems of tax administration. The first question with which the court dealt was whether any of the city's claims were barred by the statute of limitations. The actions were brought under G.L. c. 60, § 35, which provides that the collector may recover taxes in an action of contract or other appropriate proceeding. Prior to a 1946 amendment to this section, the phrase "in the same manner as for his [the collector's] own debt" was included and the section had been interpreted to require application of the statute of limitations to the action. *Rich* v. *Tuckerman*, 121 Mass. 222 (1876) (applying short statute of limitations for debts of a decedent). The court in the *Rich* case had in large part relied for its decision upon the words quoted above that were omitted in the 1946 revision of Section 35. The Court in the present case found, however, that the language of the revised Section 35 indicated no intent to change the existing rule; in addition, the legislative history showed that the purpose of the revision was to permit earlier suit by the collectors and expressed no intent to otherwise alter the meaning. The Court thus held that the six-year prescriptive period for contract actions applied and the defendant Gordon (whose last tax liability was as of July 1, 1952) was not personally liable for any tax deficiencies. This result is correct under the present statute. It is true that the general policy considerations favoring short prescriptive periods are less important in tax cases, and other policies favoring preservation of government revenue become important. If, however, a longer prescriptive period is desirable, it is a matter for remedy by the legislature, not the judiciary.

The next point decided by the Court related to the apartment corporation's claim that foreclosure of the tax title in early 1958 barred recovery of the 1957 and 1958 taxes. The taxes for these two years were not certified by the collector to the city treasurer until after the foreclosure decree, so that they formed no part of the tax account. The court held the corporation liable since foreclosure of the tax title did not affect the taxes later certified; the remedies for tax collection are cumulative, not exclusive, and foreclosure in no way affected the 1957 and 1958 taxes.

The court had, up to this point, decided that the defendant Gordon was not personally liable on those taxes assessed against her, and that the corporate defendant was personally liable for those years not certified at the time of foreclosure, i.e., 1957 and 1958. The question remained whether the corporate defendant was personally liable for any of the deficiency in the 1953-1956 taxes assessed against it, including charges and penalties, that would not be paid by the fair market value of the premises. The court held that foreclosures did not operate as a complete payment of these taxes, analogizing the situation to a mortgage foreclosure wherein the mortgagee can recover the deficiency between the debt and the value of the land at the time foreclosure by entry and possession is completed. Tax liabilities, reflected in the tax title account at the time of foreclosure, therefore, were only discharged to the extent of the fair market value of the premises on the date of foreclosure.

The court thus found the lower court erred in not permitting evidence of the fair market value of the premises to be introduced. The city had offered to show, by expert testimony and the sales price of the property, that the fair market value at the time of foreclosure was $7,500. During the tax year from 1948 through 1958 the premises had been assessed at $34,500, and the apartment corporation, in addition, sought to exclude the $7,500 value evidence upon an estoppel theory. *Gordon* v. *Lewitsky,* 333 Mass. 379, 131 N.E. 2d 174 (1955). The court rejected the estoppel argument since assessors are not agents of the city and their actions cannot bind the city. The court indicated that the trier of fact on remand could give great weight to the discrepancies between the figures but the $7,500 figure was not barred since fair market value on the foreclosure date was the issue to be determined and the evidence offered to prove this figure was relevant.

Finally the court had to decide what portion of the fair market value of the premises would be used to reduce the apartment corpora-

tion's personal liability, since the foreclosure was for the overdue taxes from 1948 through 1956, and the corporation's liability was only for the 1953 through 1956 portion thereof. The court, by a complicated analysis and construction of G.L. c. 60, § 43, as amended through Acts of 1935, c. 236, held that the priority of payment of taxes from the sum representing the fair market value at the time of foreclosure depended upon the chronological order of commitment of the taxes to the collector. The foreclosure value was therefore used to pay taxes committed in yearly order from 1948 through 1956. The city thus will collect a portion, if not all, of the taxes assessed originally against the defendant Gordon, who is no longer personally liable, and can obtain the 1953-1956 tax charges from the apartment corporation upon its personal liability, if it is sufficiently solvent to pay the judgment.

This case illustrates several truisms about local taxation. Administratively this case was poorly handled in permitting Gordon's personal liability to be barred; one year's loss would be bad enough but here five years' taxes were involved. Legislatively, the court was given the unenviable task of interpreting two statutes of major importance to local taxation, G.L. c. 60, §§ 35 and 43, that are poorly drafted. The obvious importance of adequate local tax administration requires a complete and carefully drafted statutory base.

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TAXATION—REAL ESTATE TAX. *The Atlantic Refining Company, Commonwealth intervener* v. *Assessors of Newton,* Mass. Adv. Sh. (1961) 395, 172 N.E. 2d 827.

This case involved the question of whether it was proper for Newton to assess a real estate tax on an Atlantic gasoline station and a Howard Johnson restaurant off Route 128. These premises were leased from the Commonwealth. G.L. Ch. 59, § 39A provides that "real estate owned by . . . the Commonwealth . . . if used or occupied for other than public purposes, shall be taxed to the lessees . . .".

The Supreme Judicial Court held that the property was subject to local taxation since it was used "for other than public purposes" notwithstanding the fact that the lessees were required to perform some public services. The lessees had a private profit purpose and therefore the land was held to be subject to taxation even though it was owned by the Commonwealth.

TORTS—ABUSE OF PROCESS—MALICIOUS PROSECUTION—ELEMENTS OF ACTION. *Altenhaus* v. *Louison,* Mass. Adv. Sh. (1961) 327, 172 N.E. 2d 230; *Dangel* v. *Offset Printing, Inc.,* Mass. Adv. Sh. (1961) 361, 172 N.E. 2d 610.

The two above cases deal with similar, but not identical, causes of action, the first involving the cause of action for abuse of civil process and the second dealing with malicious prosecution of a civil action.

In each case, the sustaining of a demurrer to the declaration was upheld on appeal as neither declaration stated concisely the substantive facts necessary to state a cause of action.

In the *Altenhaus* case, involving abuse of process, there apparently were no allegations that the defendant applied the attachment of the plaintiff's real estate in other than an authorized manner. The declaration contained allegations of the defendant's bad intentions, but this alone is not enough for this cause of action. The denial of the plaintiff's motion to amend, after the demurrer was sustained, was upheld as within the Court's discretion.

In the *Dangel* case, which points up the distinction between these two causes of action, the plaintiff failed to allege that the prior action terminated in his favor, one element of malicious prosecution, although favorable termination is not an element in an action for abuse of process. The plaintiff's declaration contained many allegations dealing with the lack of probable cause and the groundlessness of the prior action, neither of which is an essential element of an abuse of process case, so that the declaration could not even be supported as stating concisely a cause of action for abuse of process, although the Court construed the declaration essentially as declaring in malicious prosecution.

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TORTS—BAILMENT—LIMITATION OF LIABILITY BY CONTRACT. *D'Aloisio* v. *Morton's Inc.,* Mass. Adv. Sh. (1961) 431, 172 N.E. 2d 819.

The plaintiff here left her fur coat with the defendant for summer storage and repair. She was given a "storage receipt and contract" which limited the defendant bailee's liability to $300, the coat's value as declared by the plaintiff. The plaintiff could have been protected to a higher maximum by paying a higher charge. The coat was, on the same day as received, sent to the alteration shop, and its whereabouts from then on do not appear. When the

coat could not be located in the Fall, the plaintiff was tendered $300 by the defendant, which she refused.

The finding for the plaintiff in the amount of $2,050 on both negligence and conversion was vacated by the Appellate Division, which entered a finding for the plaintiff in the amount of $300.

The Court, in reversing the Appellate Division decision and ordering a new trial on the conversion count, held that the "storage receipt and contract," plainly so marked and signed by the plaintiff was a contract as a matter of law and not merely a "means of identification." In this case, the Court extended the doctrine of contractual limitation of liability, which could be found under these circumstances, to warehouse men and others providing storage facilities, as it had already applied to carriers. The limitation of liability under these circumstances is bindng not only with respect to recovery under the contract of bailment, but also with respect to recovery for ordinary negligence.

The limitation of liability would not, however, protect the bailee against at least any willful and intentional conversion of the property for its own benefit. Here, to recover on this basis, the plaintiff would have to show that at the time of her demand for the coat in the Fall, the defendant had it in its possession and, although able to comply with the demand, failed to do so. As the record was not clear on the matter of the defendant's possession of the coat at the time of the demand, a new trial was ordered.

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TORTS—DEFAMATION—PRIVILEGE. *Boston Nutrition Society, Inc.* v. *Stare,* Mass. Adv. Sh. (1961) 661, 173 N.E. 2d 812. *Retailers Commercial Agency, Inc., Petitioner; George I. Shore* v. *Retailers Commercial Agency, Inc.,* Mass. Adv. Sh. 755, 174 N.E. 2d 376.

Two recent decisions discuss the elements of defamation as they relate to statements alleged libelous when made *concerning* a Chapter 180 corporation and when made *by* a mercantile agency to an interested subscriber. The *Boston Nutrition* case was a suit brought against the head of the Nutrition Department of the School of Public Health of Harvard for alleged libelous statements printed in *McCall's* magazine as an answer to an inquiry concerning the Plaintiff, which commented on statements made by the Plaintiff concerning the lack of food value of "enriched white bread." The Plaintiff's declaration quoted the Defendant's response to the inquiry. Among

other things, it referred to the statements made by the Plaintiff as "scare tactics;" and that "to imply or suggest that enriched white flour can cause or contribute to the diseases listed . . . is a cruel and reckless fraud" and also that "Plaintiff's phone number is the same as the Copley Square Diet Shop, purveyors of so-called 'health foods.'" The Defendant demurred to the declaration and the demurrer was sustained.

The court adopts the rule of the *Restatement of Torts,* Section 561 (2) in setting forth the test to determine whether or not a statement is libelous when made with reference to a corporation not organized for profit. The test is met, according to the *Restatement,* when "[o]ne . . . falsely and without prejudice to so do publishes . . . matter which tends to prejudice [the corporation] in public estimation and thereby . . . interfere[s] with the conduct of its activities. . . ."

The court, in reversing the order sustaining the demurrer, said that it could not be stated as a matter of law that the words used were not reasonably capable of any defamatory meaning. The fact that questions of public health and nutrition are of public concern, and may, therefore, be the subject of a qualified privilege of fair comment was considered but this would be a matter of defense, said the court, not open on demurrer and thus if actual malice were proven at the time of the hearing, the privilege would be destroyed.

In the *Retailers Commercial Agency* case, which was apparently a case of first impression in Massachusetts, our court aligns itself with the weight of authority in deciding that a "report made by a mercantile agency to a particular subscriber whose business interest is involved is conditionally privileged." The case concerned information given by the Defendant to a client concerning the credit of the Plaintiff. Two reports were made, the first of which, the subject of this action, was substantially different from the second. Evidence at the hearing indicated that some of the statements made in the first report were "inaccurate and misleading."

In ordering a retrial, the court indicated that although such reports are conditionally privileged, the privilege is destroyed if "abused" and such abuse is not necessarily limited to proof of actual or express malice but may include proof of "absence of good faith" or "recklessness." Another suggested test is that which also has been applied in cases involving misrepresentation in the making of a positive false statement as to which the maker had special means of knowledge. The court, in suggesting these tests, rejected the argument of the Defendant that the test should be "whether or not the

Defendant used reasonable care" in that such a test would "place undue limitations on communications which the law seeks to protect."

It is to be observed that the court is careful to limit the application of these principles to cases where the report is made to an interested subscriber and that no privilege exists where the report "is published by the agency generally to subscribers having no particular interest in the report." See *Restatement of Torts,* Section 595, comment g.

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TORTS—IMMUNITY FROM SUIT—CHARITABLE CORPORATIONS. *Boxer* v. *Boston Symphony Orchestra, Inc.,* Mass. Adv. Sh. (1961) 781, 174 N.E. 2d 363.

The Supreme Judicial Court confirms the rule that public charities are immune from suit by reason of common law torts involving personal injuries to the plaintiffs. The Court reiterates that, while as an original proposition the doctrine might not commend itself to the Court today, it has been firmly imbedded in our law for over three quarters of a century, and, therefore, its termination should be at legislative rather than at judicial hands. In addition, in the instant case, the Court cited many cases as authority for the rule that it is unimportant whether certain things done by the defendant may be outside the charitable exemption, so long as the evidence discloses that the activities of the defendant are primarily educational and unquestionably within that exemption, and so long as the plaintiff was injured in the course of such exempted activities.

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TORTS—MOTOR VEHICLE—PROOF OF NEGLIGENCE. *Horwitz* v. *Sulham,* Mass. Adv. Sh. (1961) 537, 173 N.E. 2d 247.

The defendant was traveling south on the highway, towing a two-wheel box trailer behind his automobile, in which he was transporting an 800-pound horse. The plaintiff was traveling north, and when the vehicles were two or three car lengths apart, the trailer suddenly swerved across the road and struck the plaintiff's car. After the collision, it was found that the two parallel 3-inch angle irons, 1/4 inch thick and seven feet long, extending the length of the trailer, on which the "box" rested, were broken.

The auditor found that the cause of the accident was the breaking of the angle irons, but was unable to find that they were defective. An expert for the plaintiff testified that the trailer was improperly constructed, because of the use of one-quarter inch angle irons. The auditor's finding that the cause of the accident was the breaking of the angle bars was unrefuted at the jury trial.

The Court held that the mere breaking of the angle bars did not warrant a finding of the defendant's negligence, and that even assuming the angle bars were defective, there was no evidence that the defendant knew or should have known of such defect. The testimony of the expert, who had not seen the trailer, to the effect that "he would not have built a trailer with a quarter-inch angle iron" was not a sufficient basis for charging the defendant with negligence.

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TORTS—PASSENGER IN MOTOR VEHICLE—CONFERRING OF BENEFIT—PRIMA FACIE AGENCY OF DRIVER. *Falden* v. *Crook*, Mass. Adv. Sh. (1961) 365, 172 N.E. 2d 686.

In this case, the Court upheld the direction of verdicts for the defendants, owner and operator of the motor vehicle involved, on counts of ordinary negligence, and for the defendant owner on counts of gross negligence, the plaintiff recovering against the defendant operator under gross negligence. The operator, driving his employer's truck on a retail neighborhood ice cream sales route, selling mostly to children, agreed to give the minor plaintiff a ride home. While riding on the running board, the plaintiff was thrown off the truck and into a steel upright as the truck rounded a curve at thirty to thirty-five miles per hour.

The Court held that in this situation the plaintiff could not be found to be conferring any benefit upon the defendants, as any prospect of the plaintiff's future purchase of ice cream in return for the favor of a ride home was too remote to bring the case within the benefit rule. The plaintiff was merely a gratuitous guest.

Discussing another point, the Court emphasized that G.L., c. 231, § 85A does no more than carry the case to the jury as far as agency of the driver in behalf of the defendant owner is concerned. The statute goes no further than the activity of the actual driving of the truck and does not create prima facie proof of the driver's authority to invite guests to ride with him. The burden of proof on this element of the case against the owner remained with the plaintiff.

TORTS—STATUS AS GUEST—HOMEOWNER'S LIABILITY FOR INJURIES. *Pandiscio* v. *Bowen,* Mass. Adv. Sh. (1961) 657, 173 N.E. 2d 634.

This case holds that barring special circumstances, a member of the family group rendering casual household assistance at her parent's home does not assume the status of a business invitee under the "benefit" rule in an action against the parent-homeowner for injuries suffered while engaged in these chores.

Here the plaintiff, who was formerly a tenant in the home of her mother and stepfather but was no longer living there, went to the home at the express request of the mother to assist in putting up curtains. After a short conversation, the daughter went to the room where the curtains to be put up were stored and was injured when wall board placed upright against the wall for storage fell on her.

The Court, after mentioning the wide scope of the benefit rule, particularly in motor vehicle cases, held that assistance in routine or commonplace household tasks rendered by a member of the family or household group or by one of a group of acquaintances to another of the group does not remove the one assisting from the licensee or social guest status, unless the character or circumstances of the assistance make it clearly the dominant aspect of the relationship rather than a routine incident of social or group activities.

It would appear that every case of this nature will rest upon its own particular facts as to the character and circumstances of the assistance. Considering, however, that the plaintiff here went to her mother's home at the mother's express request for assistance, it seems quite clear that family members and friends will have a greater problem than strangers in bringing themselves within the status of a business invitee because of their blood or social relationship to the invitor.

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WILLS—ALTERATION—EXECUTION. *Flynn* v. *Barrington,* Mass. Adv. Sh. (1961) 383, 172 N.E. 2d 593.

This is a "jolly testator's" will, handwritten on a stationer's form and executed in the presence of three dinner guests on Christmas Eve in 1958. A pecuniary legacy to the decedent's wife bore evidence, by the juxtaposition of the arabic figures of other pecuniary legacies in the Will, of having been raised to $160,000.00 from an amount which could not have been less than $10,000.00.

Proponents offered no testimony as to the time of tampering.

The Will was admitted to probate (Essex County) and contestant appealed.

Held, that proponents had not sustained their burden of proof as to when alteration took place. Case was remanded to Probate Court for further hearing and hoped-for enlightenment, inter alia, of custody of instrument subsequent to execution, "background and circumstances of the drafting, alteration and execution of the Will and other relevant matters"—plus possible further handwriting expert testimony.

The public's perpetual penchant for homemade wills (and codicils) continues to provide profitable probate perplexities.

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WILLS—MEANING OF "HEIRS AT LAW." *Second Bank-State Street Trust Co.* v. *Weston,* Mass. Adv. Sh. (1961) 883, 174 N.E. 2d 763.

The court was faced in this case with a complicated problem of construing the phrase "heirs at law" in a trust set up by the testatrix's will. Testatrix, widow of a Massachusetts citizen, made a will in 1892 at Baltimore, Maryland, where she was domiciled. She died in 1911. The will gave the residue of her estate to a Massachusetts trustee, to pay the net income to her daughters as long as they lived, share and share alike. Issue of any deceased daughter were to take the daughter's share but, in event that all three daughters died leaving no issue, the trust fund was to go to the testatrix's "heirs at law." Among other instructions she authorized the trustee, upon request of any child or grandchild of the testatrix, to advance to the person so requesting a sum not to "exceed one half of the value of the then expectant or presumptive or vested share" of such person. All daughters died, leaving no issue, and the successor trustee sought instructions as to the distribution of the fund.

The Probate Court found that "heirs at law" meant the testatrix's heirs at her death in 1911, who were her daughters. If, however, the "heirs" are to be determined at the date of the death of the last surviving daughter in 1958, certain descendants of the testatrix's parents would take. In 1892, at the time the original will was drafted, the testatrix had brothers and sisters, some with issue, but her will mentioned only her sisters.

The court first attempted to determine the meaning of "heirs at law" in this will by seeking to find the testatrix's actual intent in using the phrase. The court considered the testatrix's language, the

context in which the language appeared, and such relevant evidence as the circumstances under which the will was drafted. The language itself gave no idea of the testatrix's meaning, and obviously her general interest was to provide for her daughters and she gave but very little thought to her collateral relatives. The main argument favoring the daughters' claim as heirs was the provision for advances; if a daughter could take a share of the principal up to one half of the expectant or presumptive or vested share, it was argued that the daughters would have to have a remainder interest. The court, however, stated that the phrase could be interpreted sensibly by treating it as permitting each daughter to request up to one half of the share of the principal from which she was receiving income, she obviously having a vested interest, in the clause's phraseology, in the life income. It was conceivable, of course, that the phrase could be interpreted to permit a daughter to request one half of what she would take as a remainderman under the "heirs at law" terminology, and under this interpretation the daughter would have an expectant or presumptive interest. The court felt, however, that the use of the language "expectant or presumptive" was not meant to refer to the daughters' estates at all but more reasonably was meant to govern the situation of a deceased daughter leaving children, while another daughter yet survived, and these children would have a presumptive or expectant share in the trust fund as contingent remaindermen. This analysis made this provision in the will of no value in determining the testatrix's actual intent in referring to "heirs at law;" thus the court had to determine who would take under the provision by the use of rules of construction.

In accordance with standard principles the court held that the interpretation of this phrase must be determined by the rules of construction established by the law of the testatrix's domicile. While the present trust was a Massachusetts trust and administrative matters are thus governed by Massachusetts law, the dispositive and substantive provisions are to be interpreted by the domiciliary law of Maryland. While Massachusetts law would determine the "heirs at law" at the time of the testatrix's death, in the absence of expressions of a contrary intent, Maryland has a special rule in certain situations which the court found applicable here. The determination of the heirs was thus made at the death of the last surviving daughter in 1958, rather than at the death of the testatrix in 1911, and the decision of the Probate Court was reversed. The discussion and documentation in this portion of the opinion provides an excellent study of this problem but, since much of the material considered applies only to Maryland, it is not discussed here.

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